chapter 4

BUSINESS ETHICS, CORPORATE SOCIAL RESPONSIBILITY, CORPORATE GOVERNANCE, AND CRITICAL THINKING

You are a senior associate consultant at Accent Pointe Consulting LLP, a consulting firm. The engagement partner has asked you to prepare an engagement plan and budget, which you dutifully complete on time. This is the first time you have prepared an engagement plan and budget. You make sure that your plan and budget are in line with your knowledge of what can and must be done to meet the client's needs. The proposed fee is $100,000. When you present the budget to the engagement partner, she goes ballistic. "What's this $100,000? This is Accent Pointe Consulting. This is the big time. What kind of consultant are you?"

"A good one," you reply. "I've created a reasonable plan, and for what we are doing for the client, that is a high-end fee."

The partner, however, does not buy your arguments. "You make this contract $200,000," she orders you, "and find a way in your engagement plan to back up that price."

- What action will you take?
- What process and guidelines will you use to determine what is the right thing to do in this context?
- If you decide that $100,000 is the correct contract price, how do you resist the partner's request to make you bill the client for $200,000?
- Will you take a different action if you know that a year from now the firm's partners will vote on whether you should be made a partner, and you believe the engagement partner's recommendation will be critical to your becoming a partner?
- Will you take a different action if you are the engagement partner and have been ordered to bill the client $200,000 by a managing partner? Note that as a partner, your share of firm profits is determined by the number of "units" you have, which is largely a function of the amount the firm bills clients for whom you are the engagement partner.
- What action will you take if you discover that the managing partner's request to bill more is a relatively isolated incident in a firm that generally bills clients accurately? You don't know the managing partner's motivation for asking you to overbill the client.
- What action will you take if you discover that the firm has a culture that encourages overbilling clients? The overbilling culture evolved within the last decade from a desire of managing partners to enjoy a financial status more nearly equal to the corporate executives of their clients, many of whom receive annual compensation in the millions of dollars.

Why Study Business Ethics?

Enron. Arthur Andersen. WorldCom. Tyco. Adelphia. Global Crossing. ImClone. These business names from the front pages of the last few years conjure images of unethical and socially irresponsible behavior by corporations and their executives. The United States Congress, employees, investors, and other critics of the power held and abused by some corporations and their management have demanded that corporate wrongdoers be punished and that future wrongdoers be deterred. Consequently shareholders, creditors, and state and federal attorneys general have brought several civil and criminal actions against wrongdoing corporations and their executives. Congress has also got in on the action, passing the Sarbanes–Oxley Act of 2002, which increased penalties for corporate wrongdoers and established rules designed to deter and prevent future wrongdoing. The purpose of the statute is to encourage and enable corporate executives to be ethical and socially responsible.

But statutes and civil and criminal actions can go only so far in directing business managers down an ethical path. And while avoiding liability by complying with the law is one reason to be ethical and socially responsible, there are noble and economic reasons that encourage current and future business executives to study business ethics.

Although it is tempting to paint all businesses and all managers with the same brush that colors unethical and irresponsible corporations and executives, in reality corporate executives are little different from you, your friends, and your acquaintances. All of us from time to time fail to do the right thing, and we know that people have varying levels of commitment to acting ethically. The difference between most of us and corporate executives is that they are in positions of power that allow them to do greater damage to others when they act unethically or socially irresponsibly. They also act under the microscope of public scrutiny.

It is also tempting to say that current business managers are less ethical than managers historically. But as Federal Reserve Chairman Alan Greenspan said, "It is not that humans have become any more greedy than in generations past. It is that the avenues to express greed have grown enormously."

This brings us to the first and most important reason why we need to study business ethics: to make better decisions for ourselves, the businesses we work for, and the society we live in. As you read this chapter, you will study not only the different theories that attempt to define ethical conduct, but more importantly you will learn to use a framework or strategy for making decisions. This framework will increase the likelihood you have considered all the facts affecting your decision. By learning a methodology for ethical decision making and studying common thinking errors, you will improve your ability to make ethical decisions.

Another reason we study ethics is to understand ourselves and others better. While studying the various ethical theories, you will see concepts that reflect your own thinking and the thinking of others. This chapter, by exploring ethical theories systematically and pointing out the strengths and weaknesses of each ethical theory, should help you understand better why you think the way you do and why others think the way they do. By studying ethical theories, learning a process for ethical decision making, and understanding common reasoning fallacies, you should also be better able to decide how you should think and whether you should be persuaded by the arguments of others. Along the way, by better understanding where others are coming from and avoiding fallacious reasoning, you should become a more persuasive speaker and writer.

There are also cynical reasons for executives to study business ethics. By learning how to act ethically and in fact doing so, businesses forestall public criticism, reduce lawsuits against them, prevent Congress from passing onerous legislation, and make higher profits. For many corporate actors, however, these are not reasons to act ethically, but instead the natural consequences of so acting.

While we are studying business ethics, we will also examine the role of the law in defining ethical conduct. Some argue that it is sufficient for corporations and executives to comply with the requirements of the law; commonly, critics of the corporation point out that since laws cannot and do not encompass all expressions of ethical behavior, compliance with the law is necessary but not sufficient to ensure ethical conduct. This introduces us to one of the major issues in the corporate social responsibility debate.

The Corporate Social Responsibility Debate

Although interest in business ethics education has increased greatly in the last 30 years, that interest is only the latest stage in a long struggle to control corporate misbehavior. Ever since large corporations emerged in the late 19th century, such firms have been heroes to some and villains to others. Large corporations perform essential national and global economic functions, including raw material extraction, energy production,

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Unethical Business Practices in China

American executives are not alone in being charged with unethical and illegal business practices. In China in 2002, for example, prosecutors charged executives of Zhengzhou Baiwen Company, a partly state-owned company, with accounting fraud. Baiwen executives were charged with manipulating the company's books to hide losses. As a result, Baiwen was able to obtain Chinese government approval to sell new shares to investors in 1997.

The crackdown on Baiwen executives suggests that Chinese regulators are treating accounting fraud more seriously than in the past. Unlike the American public who, thanks to a free press, read daily newspaper stories of scandals at American corporations, Chinese investors are largely unaware of the extent of accounting problems at Chinese companies whose stock is listed on the Chinese stock exchange. Chinese market regulators estimate that almost half the 1,500 listed Chinese companies have committed some form of accounting irregularity.

In another example, in 2005, German authorities began investigating allegations that German automaker Daimler Chrysler had kept dozens of secret bank accounts to bribe foreign officials. Bribery has been illegal across the European Union since 1997, yet officials have found it hard to change a culture that had previously openly permitted tax deductions for overseas bribery.

transportation, and communication, as well as providing consumer goods and entertainment to millions of people.

Critics, however, claim that corporations in their pursuit of profits ruin the environment, mistreat employees, sell shoddy and dangerous products, produce immoral television shows and motion pictures, and corrupt the political process. Critics claim that even when corporations provide vital and important services, business is not nearly as accountable to the public as are organs of government. For example, the public has little to say about the election of corporate directors or the appointment of corporate officers. This lack of accountability is aggravated by the large amount of power that big corporations wield in America and much of the rest of the world.

These criticisms and perceptions have led to calls for changes in how corporations and their executives make decisions. The main device for checking corporate misdeeds has been the law. The perceived need to check abuses of business power was a force behind the New Deal laws of the 1930s and extensive federal regulations enacted in the 1960s and 1970s. Some critics, however, believe that legal regulation, while an important element of any corporate control scheme, is insufficient by itself. They argue that businesses should adhere to a standard of ethical or socially responsible behavior that is higher than the law.

One such standard is the stakeholder theory of corporate social responsibility. It holds that rather than merely striving to maximize profits for its shareholders, a corporation should balance the interests of shareholders against the interests of other corporate stakeholders, such as employees, suppliers, customers, and the community. To promote such behavior, some corporate critics have proposed changes that increase the influence of the various stakeholders in the internal governance of a corporation. We will study many of these proposals later in the chapter. You will also learn later that an ethical decision-making process requires a business executive to anticipate the effects of a corporate decision on the various corporate stakeholders.

Despite concerns about abuses of power, big business has contributed greatly to the unprecedented abundance in America and elsewhere. Partly for this reason and partly because many businesses attempt to be ethical actors, critics have not totally dominated the debate about control of the modern corporation. Defenders of businesses argue that in a society founded on capitalism, profit maximization should be the main goal of businesses: the only ethical norms firms must follow are those embodied in the law or those impacting profits. In short, they argue that businesses that maximize profits within the limits of the law are acting ethically. Otherwise, the marketplace would discipline them for acting unethically by reducing their profits.

Fed Chairman Alan Greenspan wrote in 1963 that moral values are the power behind capitalism. He wrote, "Capitalism is based on self-interest and self-esteem; it holds integrity and trustworthiness as cardinal virtues and makes them pay off in the marketplace, thus demanding that men survive by means of virtue, not of vices." Note that companies that are successful decade after decade, like Procter & Gamble and Johnson & Johnson, adhere to society's core values.

We will cover other arguments supporting and criticizing profit maximization later in the chapter, where we will

consider fully proposals to improve corporate governance and accountability. For now, however, having set the stage for the debate about business ethics and corporate social responsibility, we want to study the definitions of ethical behavior.

Ethical Theories

For centuries, religious and secular scholars have explored the meaning of human existence and attempted to define a "good life." In this section, we will define and examine some of the most important theories of ethical conduct.

As we cover these theories, much of what you read will be familiar to you. The names may be new, but almost certainly you have previously heard speeches and read writings of politicians, religious leaders, and commentators that incorporate the values in these theories. You will discover that your own thinking is consistent with one or more of the theories. You can also recognize the thinking of friends and antagonists in these theories.

None of these theories are necessarily invalid, and many people believe strongly in any one of them. Whether you believe your theory to be right and the others to be wrong, it is unlikely that others will accept what you see as the error of their ways and agree with all your values. Instead, it is important for you to recognize that people's ethical values can be as diverse as human culture. Therefore, no amount of argumentation appealing to theories you accept is likely to influence someone who subscribes to a different ethical viewpoint.

This means that if you want to be understood by and to influence someone who has a different ethical underpinning than you do, you must first determine his ethical viewpoint and then speak in an ethical language that will be understood and accepted by him. Otherwise, you and your opponent are like the talking heads on nighttime cable TV news shows, whose debates often are reduced to shouting matches void of any attempt to understand the other side.

The four ethical theories we will study are rights theory, justice theory, utilitarianism, and profit maximization. Some of these theories focus on results of our decisions or actions: do our decisions or actions produce the right results? Theories that focus on the consequences of a decision are **teleological** ethical theories. For example, a teleological theory may justify a manufacturing company laying off 5,000 employees, because the effect is to keep the price of manufactured goods low and to increase profits for the company's shareholders.

Other theories focus on the decision or action itself, irrespective of what results it produces. Theories that focus on decisions or actions alone are **deontological** ethical theories. For example, a deontological theory may find unacceptable that any competent employee loses his job, even if the layoff's effect is to reduce prices to consumers and increase profits.

LOG ON

Go to
www.utm.edu/research/iep/
The Internet Encyclopedia of Philosophy gives you background on all the world's great philosophers from Aenesidemus to Zeno. You can also study the development of philosophy from ancient times to the present. Many of the world's great philosophers addressed the question of ethical or moral conduct.

First, we will cover rights theory, which is a deontological theory. Next will be justice theory, which has concepts common to rights theory, but a focus primarily on outcomes. Our study of ethical theories will conclude with two additional teleological theories, utilitarianism and profit maximization.

Rights Theory

Rights theory encompasses a variety of ethical philosophies holding that certain human rights are fundamental and must be respected by other humans. The focus is on each individual member of society and her rights. As an actor, each of us faces a moral compulsion not to harm the fundamental rights of others.

Kantianism

Few rights theorists are strict deontologists, and one of the few is 18th-century philosopher Immanuel Kant. Kant viewed humans as moral actors that are free to make choices. He believed humans are able to judge the morality of any action by applying his famous **categorical imperative.** One formulation of the categorical imperative is, "Act only on that maxim whereby at the same time you can will that it shall become a universal law." This means that we judge an action by applying it universally.

Suppose you want to borrow money even though you know that you will never repay it. To justify this action using the categorical imperative, you state the following maxim or rule: "When I want money, I will borrow money and promise to repay it, even though I know I won't repay." According to Kant, you would not want this maxim to become a universal law, because no one would believe in promises to repay debts and you would not be able to borrow money when you want. Thus, your maxim

or rule fails to satisfy the categorical imperative. You are compelled, therefore, not to promise falsely that you will repay a loan.

Kant had a second formulation of the categorical imperative: "Always act to treat humanity, whether in yourself or in others, as an end in itself, never merely as a means." That is, we may not use or manipulate others to achieve our own happiness. In Kant's eyes, if you falsely promise a lender to repay a loan, you are using that person because she would not agree to the loan if she knew all the facts.

Modern Rights Theories Strict deontological ethical theories like Kant's face an obvious problem: the duties are absolute. We can never lie and never kill, even though most of us find lying and killing acceptable in some contexts, such as in self-defense. Responding to these difficulties, some modern philosophers have proposed mixed deontological theories. There are many theories here, but one popular theory requires us to abide by a moral rule unless a more important rule conflicts with it. In other words, our moral compulsion is not to compromise a person's right unless a greater right takes priority over it.

For example, members of society have the right not to be lied to. Therefore, in most contexts you are morally compelled not to tell a falsehood. That is an important right, because it is critical to a society that we be able to rely on someone's word. If, however, you could save someone's life by telling a falsehood, such as telling a lie to a criminal about where a witness who will testify against him can be found, you probably will be required to save that person's life by lying about his whereabouts. In this context, the witness's right to live is a more important right than the criminal's right to hear the truth. In effect, one right "trumps" the other right.

What are these fundamental rights? How do we rank them in importance? Seventeenth-century philosopher John Locke argued for fundamental rights that we see embodied in the constitutions of modern democratic states: the protection of life, liberty, and property. Libertarians and others include the important rights of freedom of contract and freedom of expression. Modern liberals, like Bertolt Brecht, argued that all humans have basic rights to employment, food, housing, and education. In the 1990s, the right to health care became part of the liberal rights agenda.

Strengths of Rights Theory The major strength of rights theory is that it protects fundamental rights, unless some greater right takes precedence. This means that

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The Golden Rule in the World's Religions and Cultures

Immanuel Kant's Categorical Imperative, which is one formulation of Rights Theory, has its foundations in the Golden Rule. Note that the Golden Rule exists in all cultures and in all countries of the world. Here is a sampling.

BUDDHISM: Hurt not others in ways that you would find hurtful.

CHRISTIANITY: Do to others as you would have others do to you.

CONFUCIANISM: Do not to others what you would not like yourself.

GRECIAN: Do not that to a neighbor which you shall take ill from him.

HINDUISM: This is the sum of duty: do nothing to others which if done to you would cause you pain.

HUMANISM: Individual and social problems can only be resolved by means of human reason, intelligent effort, and critical thinking joined with compassion and a spirit of empathy for all living beings.

ISLAM: No one of you is a believer until he desires for his brother that which he desires for himself.

JAINISM: In happiness and suffering, in joy and grief, we should regard all creatures as we regard our own self.

JUDAISM: Whatever is hateful to you, do not to another.

NATIVE AMERICAN SPIRITUALITY: Respect for all life is the foundation.

PERSIAN: Do as you would be done by.

ROMAN: Treat your inferiors as you would be treated by your superiors.

SHINTOISM: The heart of the person before you is a mirror. See there your own form.

SIKHISM: As you deem yourself, so deem others.

TAOISM: Regard your neighbor's gain as your own gain, and your neighbor's loss as your own loss.

YORUBAN: One going to take a pointed stick to pinch a baby bird should first try it on himself to feel how it hurts.

ZOROASTRIANISM: That nature alone is good which refrains from doing to another whatsoever is not good for itself.

members of modern democratic societies have extensive liberties and rights that they need not fear will be taken away by their government or other members of society.

Criticisms of Rights Theory Most of the criticisms of rights theory deal with the near absolute yet relative value of the rights protected, making it difficult to articulate and administer a comprehensive rights theory. First, it is difficult to achieve agreement about which rights are protected. Rights fundamental to modern countries like the United States (such as many women's rights) are unknown or severely restricted in countries like Pakistan or Saudi Arabia. Even within one country, citizens disagree on the existence and ranking of rights. For example, some Americans argue that the right to health care is an important need that should be met by government or a person's employer. Other Americans believe funding universal health care would interfere with the libertarian right to limited government intervention in our lives.

In addition, rights theory does not concern itself with the costs or benefits of requiring respect for another's right. For example, rights theory probably justifies the protection of a neo-Nazi's right to spout hateful speech, even though the costs of such speech, including damage to relations between ethnic groups, may far outweigh any benefits the speaker, listeners, and society receives from the speech.

Moreover, rights theory promotes moral fanaticism and creates a sense of entitlement reducing innovation, entrepreneurship, and production. If, for example, I am entitled to a job, a place to live, food, and health care regardless of how hard I work, how motivated am I to work to earn those things?

Justice Theory

In 1971, John Rawls published his book *A Theory of Justice,* the philosophical underpinning for the bureaucratic welfare state. Rawls reasoned that it was right for governments to redistribute wealth in order to help the poor and disadvantaged. He argued for a just distribution of society's resources by which a society's benefits and burdens are allocated fairly among its members.

Rawls expressed this philosophy in his **Greatest Equal Liberty Principle:** each person has an equal right to basic rights and liberties. He qualified or limited this principle with the **Difference Principle:** social inequalities are acceptable only if they cannot be eliminated without making the worst-off class even worse off. The basic structure is perfectly just, he wrote, when the prospects of the least fortunate are as great as they can be.

Rawls's justice theory has application in the business context. Justice theory requires decision makers to be guided by fairness and impartiality. It holds that businesses should focus on outcomes: are people getting what they deserve? It would mean, for example, that a business deciding in which of two communities to build a new manufacturing plant should consider which community has the greater need for economic development.

Chief among Rawls's critics was his Harvard colleague Robert Nozick. Nozick argued that the rights of the individual are primary and that nothing more was justified than a minimal government that protected against violence and theft and ensured the enforcement of contracts. Nozick espoused a libertarian view that unequal distribution of wealth is moral if there is equal opportunity. Applied to the business context, Nozick's formulation of justice would permit a business to choose between two manufacturing plant sites after giving each community the opportunity to make its best bid for the plant. Instead of picking the community most in need, the business may pick the one offering the best deal.

Strengths of Justice Theory The strength of Rawls's justice theory lies in its basic premise, the protection of those who are least advantaged in society. Its motives are consistent with the religious and secular philosophies that urge humans to help those in need. Many religions and cultures hold basic to their faith the assistance of those who are less fortunate.

Criticisms of Justice Theory Rawls's justice theory shares some of the criticisms of rights theory. It treats equality as an absolute, without examining the costs of producing equality, including reduced incentives for innovation, entrepreneurship, and production. Moreover, any attempt to rearrange social benefits requires an accurate measurement of current wealth. For example, if a business is unable to measure accurately which employees are in greater need of benefits due to their wealth level, application of justice theory may make the business a Robin Hood in reverse: taking from the poor to give to the rich.

Utilitarianism

Utilitarianism requires a decision maker to maximize utility for society as a whole. Maximizing utility means achieving the highest level of satisfactions over dissatisfactions. This means that a person must consider the benefits and costs of her actions to everyone in society.

A utilitarian will act only if the benefits of the action to society outweigh the societal costs of the action. Note that the focus is on society as a whole. This means a

decision maker may be required to do something that harms her if society as a whole is benefited by her action.

A teleological theory, utilitarianism judges our actions as good or bad depending on their consequences. This is sometimes expressed as "the ends justify the means."

Utilitarianism is most identified with 19th-century philosophers Jeremy Bentham and John Stuart Mill. Bentham argued that maximizing utility meant achieving the greatest overall balance of pleasure over pain. A critic of utilitarianism, Thomas Carlyle, called utilitarianism "pig philosophy," because it appeared to base the goal of ethics on the swinish pleasures of the multitude.

Mill thought Bentham's approach too narrow and broadened the definition of utility to include satisfactions such as health, knowledge, friendship, and aesthetic delights. Responding to Carlyle's criticisms, Mill also wrote that some satisfactions count more than others. For example, the pleasure of seeing wild animals free in the world may be a greater satisfaction morally than shooting them and seeing them stuffed in one's den.

How does utilitarianism work in practice? It requires that you consider not just the impact of decisions on yourself, your family, and your friends, but also the impact on everyone in society. Before deciding whether to ride a bicycle to school or work rather than to drive a car, a utilitarian would consider the wear and tear on her clothes, the time saved or lost by riding a bike, the displeasure of riding in bad weather, her improved physical condition, her feeling of satisfaction for not using fossil fuels, the cost of buying more food to fuel her body for the bike trips, the dangers of riding near automobile traffic, and a host of other factors that affect her satisfaction and dissatisfaction.

But her utilitarian analysis doesn't stop there. She has to consider her decision's effect on the rest of society. Will she interfere with automobile traffic flow and decrease the driving pleasure of automobile drivers? Will commuters be encouraged to ride as she does and benefit from doing so? Will her lower use of gasoline for her car reduce demand and consumption of fossil fuels, saving money for car drivers and reducing pollution? Will her and other bike riders' increased food consumption drive up food prices and make it less affordable for poor families? This only scratches the surface of her utilitarian analysis.

The process we used above, so-called **act utilitarianism,** judges each act separately, assessing a single act's benefits and costs to society's members. Obviously, a person cannot make an act utilitarian analysis for every decision. It would take too much time.

Utilitarianism recognizes that human limitation. **Rule utilitarianism** judges actions by a rule that over the long run maximizes benefits over costs. For example, you may find that taking a shower every morning before school or work maximizes society's satisfactions, as a rule. Most days, people around you will be benefited by not having to smell noisome odors, and your personal and professional prospects will improve by practicing good hygiene. Therefore, you are likely to be a rule utilitarian and shower each morning, even though some days you may not contact other people.

Many of the habits we have are the result of rule utilitarian analysis. Likewise, many business practices, such as a retailer's regular starting and closing times, also are based in rule utilitarianism.

Strengths of Utilitarianism What are the strengths of utilitarianism as a guide for ethical conduct? It is easy to articulate the standard of conduct: you merely need to do what is best for society as a whole. It also coincides with values of most modern countries like the United States: it is capitalist in nature by focusing on total social satisfactions, benefits, welfare, and wealth, not on the allocations of pleasures and pains, satisfactions and dissatisfactions, and wealth.

Criticisms of Utilitarianism Those strengths also expose some of the criticisms of utilitarianism as an ethical construct. It is difficult to measure one's own pleasures and pains and satisfactions and dissatisfactions, let alone those of all of society's members. In addition, those benefits and costs almost certainly are unequally distributed across society's members. It can foster a tyranny of the majority that may result in morally monstrous behavior, such as a decision by a 100,000-person community to use a lake as a dump for human waste because only one person otherwise uses or draws drinking water from the lake.

That example exhibits how utilitarianism differs from rights theory. While rights theory may protect a person's right to clean drinking water regardless of its cost, utilitarianism considers the benefits and costs of that right as only one factor in the total mix of society's benefits and costs. In some cases, the cost of interfering with someone's right may outweigh the benefits to society, resulting in the same decision that rights theory produces. But where rights theory is essentially a one-factor analysis, utilitarianism requires a consideration of that factor and a host of others as well.

A final criticism of utilitarianism is that it is not constrained by law. Certainly, the law is a factor in utilitarian

analysis. Utilitarian analysis must consider, for example, the dissatisfactions fostered by not complying with the law and by creating an environment of lawlessness in a society. Yet the law is only one factor in utilitarian analysis. The pains caused by violating the law may be offset by benefits the violation produces. Most people, however, are rule utilitarian when it comes to law, deciding that obeying the law in the long run maximizes social utility.

Profit Maximization

Profit maximization as an ethical theory requires a decision maker to maximize a business's long-run profits within the limits of the law. It is based in the *laissez faire* theory of capitalism first expressed by Adam Smith in the 18th century and more recently promoted by liberal economists such as Milton Friedman and Thomas Sowell. Liberal economists argue total social welfare is optimized if humans are permitted to work toward their own selfish goals. The role of governments and law is solely to ensure the workings of a free market by not interfering with economic liberty, eliminating collusion among competitors, and promoting accurate information in the marketplace.

By focusing on results—maximizing total social welfare—profit maximization is a teleological ethical theory. It is closely related to utilitarianism, but it differs fundamentally in how ethical decisions are made. While utilitarianism maximizes social utility by focusing the actor on everyone's satisfactions and dissatisfactions, profit maximization optimizes total social utility by narrowing the actor's focus, requiring the decision maker to make a decision that merely maximizes profits for himself or his organization.

Strengths of Profit Maximization

How can we define ethical behavior as acting in one's selfish interest? As you probably already learned in a microeconomics course, this apparent contradiction is explained by the consequences of all of us being profit maximizers. By working in our own interests, we compete for society's scarce resources (iron ore, labor, and land, to name a few), which are allocated to those people and businesses that can use them most productively. By allocating society's resources to their most efficient uses, as determined by a free market, we maximize total social utility or benefits. Society as a whole is bettered if all of us compete freely for its resources by trying to increase our personal or business profits. If we fail to maximize profits, some of society's resources will be allocated to less productive uses that reduce society's total welfare.

In addition, profit maximization results in ethical conduct because it requires society's members to act within the constraints of the law. A profit maximizer, therefore, acts ethically by complying with society's mores as expressed in its laws.

Moreover, each decision maker and business is disciplined by the marketplace. Consequently, profit maximization analysis probably requires a decision maker to consider the rights protected by rights theory and justice theory. Ignoring important rights of employees, customers, suppliers, communities, and other stakeholders may negatively impact a corporation's profits. A business that engages in behavior that is judged unethical by consumers and other members of society is subject to boycotts, adverse publicity, demands for more restrictive laws, and other reactions that damage its image, decrease its revenue, and increase its costs.

Consider for example, the reduced sales of Martha Stewart branded goods at Kmart after Ms. Stewart was accused of trading ImClone stock while possessing inside information. Consider also the fewer number of upcoming college graduates willing to work for Enron in the wake of adverse publicity and indictments against Enron's executives for misstating its financial results. Finally, note the higher cost of capital for firms like Adelphia as investors bid down the stock price of companies accused of accounting irregularities and other wrongdoing.

All these reactions to perceived unethical conduct impact the business's profitability in the short and long run, motivating that business to make decisions that comply with ethical views that transcend legal requirements.

Criticisms of Profit Maximization

The strengths of profit maximization as a model for ethical behavior also suggest criticisms and weaknesses of the theory. Striking at the heart of the theory is the criticism that corporate managers are subject to human failings that make it impossible for them to maximize corporate profits. The failure to discover and process all relevant information and varying levels of aversion to risk can result in one manager making a different decision than another manager. Group decision making in the business context introduces other dynamics that interfere with rational decision making. Social psychologists have found that groups often accept a higher level of risk than they would as individuals. There is also the tendency of a group to internalize the group's values and suppress critical thought.

Furthermore, even if profit maximization results in an efficient allocation of society's resources and maximization of total social welfare, it does not concern itself with how wealth is allocated within society. In America, more than 50 percent of all wealth is held by 10 percent of the

population. To some people, that wealth disparity is unacceptable. To liberal economists, wealth disparity is a necessary component of a free market that rewards hard work, acquired skills, innovation, and risk taking. Yet critics of profit maximization respond that market imperfections and a person's position in life at birth interfere with his ability to compete.

Critics charge that the ability of laws and market forces to control corporate behavior is limited, because it requires lawmakers, consumers, employees, and other constituents to detect unethical corporate acts and take appropriate steps. Even if consumers notice irresponsible behavior and inform a corporation, a bureaucratic corporate structure may interfere with the information being received by the proper person inside the corporation. If instead consumers are silent and refuse to buy corporate products because of perceived unethical acts, corporate management may notice a decrease in sales, yet attribute it to something other than the corporation's unethical behavior.

Critics also argue that equating ethical behavior with legal compliance is a tautology in countries like the United States where businesses distort the lawmaking process by lobbying legislators and making political contributions. It cannot be ethical, they argue, for businesses to comply with laws reflecting the interests of businesses.

Profit maximization proponents respond that many laws restraining businesses are passed despite businesses lobbying against those laws. The Sarbanes–Oxley Act of 2002, which increases penalties for wrongdoing executives, requires CEOs to certify financial statements, and imposes internal governance rules on public companies, is such an example. So are laws restricting drug companies from selling a drug unless it is approved by the Food and Drug Administration and requiring environmental impact studies before a business may construct a new manufacturing plant. Moreover, businesses are nothing other than a collection of individual stakeholders, which includes employees, shareholders, and their communities. When they lobby, they lobby in the best interests of all these stakeholders.

Critics respond that ethics transcends law, requiring in some situations that businesses adhere to a higher standard than required by law. We understand this in our personal lives. For example, despite the absence of law dictating for the most part how we treat friends, we know that ethical behavior requires us to be loyal to friends and to spend time with them when they need our help. In the business context, a firm may be permitted to release employees for nearly any reason, except the few legally banned bases of discrimination (such as race, age, and gender), yet some critics will argue businesses should not terminate an employee for other reasons currently not banned by most laws (such as sexual orientation or appearance). Moreover, these critics further argue that businesses—due to their influential role in a modern society—should be leaders in setting a standard for ethical conduct.

Profit maximizers respond that such an ethical standard is difficult to define and hampers efficient decision making. Moreover, they argue that experience shows the law has been a particularly relevant definition of ethical conduct. Consider that all the recent corporate scandals would have been prevented had the executives merely complied with the law. For example, Enron executives illegally kept some liabilities off the firm's financial statements. An Arthur Andersen partner illegally destroyed evidence. Tyco and Adelphia executives illegally looted corporate assets. Had these executives simply complied with the law and maximized their firms' long-run profits, none of the recent ethical debacles would have occurred.

Critics of profit maximization respond that the recent corporate crises at companies like Enron and WorldCom prove that flaws in corporate governance encourage executives to act unethically. These examples, critics say, show that many executives do not maximize profits for their firms. Instead, they maximize their own profits at the expense of the firm and its shareholders. They claim that stock options and other incentives intended to align the interests of executives with those of shareholders promote decisions that raise short-term profits to the long-run detriment of the firms. They point out that many CEOs and other top executives negotiate compensation plans that do not require them to stay with the firm long term and which allow them to benefit enormously from short-term profits. Executive greed, encouraged by these perverse executive compensation plans, also encourage CEOs and other executives to violate the law.

Defenders of business, profit maximization, and capitalist economics point out that it is nearly impossible to stop someone who is bent on fraud. A dishonest executive will lie to shareholders, creditors, board members, and the public and also treat the law as optional. Yet enlightened proponents of the modern corporation accept that there are problems with corporate management culture that require changes. They know that an unconstrained CEO, ethically uneducated executives, perverse compensation incentives, and inadequate supervision of executives by the firm's CEOs, board of directors, and shareholders present golden opportunities to the unscrupulous person and make unwitting accomplices of the ignorant and the powerless.

Ethics in Action

Halliburton Company's Statement of Ethical Business Practices

Oil services giant Halliburton Company is one of many American corporations to adopt an ethics code. Here is Halliburton's statement of "Ethical Business Practices." Particularly relevant is the second paragraph.

Ethical Business Practices

Company policy requires Directors, employees and agents to observe high standards of business and personal ethics in the conduct of their duties and responsibilities. Directors and employees must practice fair dealing, honesty and integrity in every aspect of dealing with other Company employees, the public, the business community, shareholders, customers, suppliers, competitors and government authorities. When acting on behalf of the Company, Directors and employees shall not take unfair advantage through manipulation, concealment, abuse of privileged information, misrepresentation of material facts, or other unfair-dealing practices. Company policy prohibits unlawful discrimination against employees, shareholders, Directors, officers, customers or suppliers on account of race, color, age, sex, religion or national origin. All persons shall be treated with dignity and respect and they shall not be unreasonably interfered with in the conduct of their duties and responsibilities.

No Director or employee should be misguided by any sense of loyalty to the Company or a desire for profitability that might cause him or her to disobey any applicable law or Company policy. Violation of Company policy will constitute grounds for disciplinary action, including, when appropriate, termination of employment.

Commercial Bribery

Company policy prohibits commercial bribes, kickbacks and other similar payoffs and benefits paid to any suppliers or customers.

Accounting Controls, Procedures & Records

Applicable laws and Company policy require the Company to keep books and records that accurately and fairly reflect its transactions and the dispositions of its assets.

Use & Disclosure of Inside Information

Company policy prohibits disclosure of material inside information to anyone other than persons within the Company whose positions require them to know such information.

Confidential or Proprietary Information

Company policy prohibits employees from disclosing confidential or proprietary information outside the Company, either during or after employment, without Company authorization to do so.

Conflicts of Interest

Company policy prohibits conflicts between the interests of its employees and the Company.

Fraud & Similar Irregularities

Company policy prohibits fraud and establishes procedures to be followed concerning the recognition, reporting and investigation of suspected fraud.

Improving Corporate Governance and Corporate Social Responsibility Even if we cannot stop all fraudulent executives, we can modify the corporate governance model to educate, motivate, and supervise executives and thereby improve corporate social responsibility. Corporate critics have proposed a wide variety of cures, all of which have been implemented to some degree and with varying degrees of success.

Ethics Codes Many large corporations and several industries have adopted codes of ethics or codes of conduct to guide executives and other employees. The Sarbanes–Oxley Act of 2002 requires a public company to disclose whether it has adopted a code of ethics for senior financial officers, and to disclose any change in the code or waiver of the code's application.

There are two popular views of such codes. One sees the codes as genuine efforts to foster ethical behavior within a firm or an industry. The other view regards them as thinly disguised attempts to make the firm function better, to mislead the public into believing the firm behaves ethically, to prevent the passage of legislation that would impose stricter constraints on business, or to limit competition under the veil of ethical standards. Even where the first view is correct, ethical codes fail to address concretely all possible forms of corporate misbehavior. Instead, they often emphasize either the behavior required for the firm's effective internal function, such as not accepting gifts from customers, or the relations between competitors within a particular industry, such as prohibitions on some types of advertising.

Better corporate ethics codes make clear that the corporation expects employees not to violate the law in a mistaken belief that loyalty to the corporation or corporate profitability requires it. An example is the

Halliburton statement of "Ethical Business Practices," which appears in an Ethics in Action box. Such codes work best, however, when a corporation also gives its employees an outlet for dealing with a superior's request to do an unethical act. That outlet may be the corporate legal department or corporate ethics office.

Ethical Instruction Some corporations require their employees to enroll in classes that teach ethical decision making. The idea is that a manager trained in ethical conduct will recognize unethical actions before they are taken and deter herself and the corporation from the unethical acts.

While promising in theory, in practice many managers are resistant to ethical training that requires them to examine their principles. They are reluctant to set aside a set of long-held principles with which they are comfortable. Therefore, there are some doubts whether managers are receptive to ethical instruction. Even if the training is accepted, will managers retain the ethical lessons of their training and use it, or will time and other job-related pressures force a manager to think only of completing the job at hand?

Moreover, what ethical values should be taught? Is it enough to teach only one, a few, or all the theories of ethical conduct? Corporations mostly support profit maximization, because it maximizes shareholder value. But should a corporation also teach rights theory and expect its employees to follow it? Or should rights theory be treated as only a component of profit maximization?

Most major corporations today express their dedication to ethical decision making by having an ethics officer who is not only responsible for ethical instruction, but also in charge of ethical supervision. The ethics officer may attempt to instill ethical decision making as a component of daily corporate life by sensitizing employees to the perils of ignoring ethical issues. The ethics officer may also be a mentor or sounding board for all employees who face ethical issues.

Whether an ethics officer is effective, however, is determined by the level of commitment top executives make to ethical behavior and the position and power granted to the ethics officer. For example, will top executives and the board of directors allow an ethics officer to nix an important deal on ethical grounds or will they replace the ethics officer with another executive whose ethical views permit the deal? Therefore, probably more important than an ethics officer is a CEO with the character to do the right thing.

Greater Shareholder Role in Corporations Since shareholders are the ultimate stakeholders in a corporation in a capitalist economy, some corporate critics argue that businesses should be more attuned to shareholders' ethical values and that shareholder control of the board of directors and executives should be increased. This decentralization of ethical decision making, the theory goes, should result in corporate decisions that better reflect shareholders' ethical values.

Yet this decentralization of power flies in the face of the rationale for the modern corporation, which in part is designed to centralize management in the board of directors and top officers and to free shareholders from the burden of managing their investments in the corporation. Significant efficiencies are lost if corporate executives are required to divine and apply shareholders' ethical values before making a decision.

In addition, divining the shareholders' ethical viewpoint may be difficult. While nearly all shareholders are mostly profit driven, a small minority of shareholders have other agendas, such as protecting the environment or workers' rights, regardless of the cost to the corporation. It is often not possible to please all shareholders.

Nonetheless, increasing shareholder democracy by enhancing the shareholders' role in the nomination and election of board members is essential to uniting the interests of shareholders and management. So is facilitating the ability of shareholders to bring proposals for ethical policy to a vote of shareholders. In the last several years, for public companies at least, the Securities and Exchange Commission has taken several steps to increase shareholder democracy. These steps, which are covered fully in Chapter 45, are having their intended effect. For example, shareholders of EMC Corporation approved a proposal recommending that the company's board comprise a majority of independent directors. Mentor Graphics Corporation shareholders voted in a resolution that any significant stock option plan be shareholder-approved. Moreover, the New York Stock Exchange and NASDAQ require companies listed on those exchanges to submit for shareholder approval certain actions, such as approval of stock option plans.

Consider All Stakeholders' Interests Utilitarianism analysis clearly requires an executive to consider a decision's impact on all stakeholders. How else can one determine all the benefits and costs of the decision? Likewise, modern rights theory also dictates considering all stakeholders' rights, including not compromising an important right unless trumped by another. Kant's categorical imperative also mandates a concern for others by requiring one to act as one would require others to act.

Critics of corporations and modern proponents of profit maximization argue that more responsible and ethical decisions are made when corporate managers consider

the interests of all stakeholders, including not only shareholders, but also employees, customers, suppliers, the community, and others impacted by a decision. For profit maximizers, the wisdom of considering all stakeholders is apparent, because ignoring the interests of any stakeholder may negatively affect profits. For example, a decision may impact a firm's ability to attract high quality employees, antagonize consumers, alienate suppliers, and motivate the public to lobby lawmakers to pass laws that increase a firm's cost of doing business. This wisdom is reflected in the Guidelines for Ethical Decision Making, which you will learn in the next section.

Nonetheless, there are challenges when a corporate manager considers the interests of all stakeholders. Beyond the enormity of identifying all stakeholders, stakeholders' interests may conflict, requiring a compromise that harms some stakeholders and benefits others. In addition, the impact on each stakeholder group may be difficult to assess accurately.

For example, if a manager is considering whether to terminate the 500 least productive employees during an economic downturn, the manager will note that shareholders will benefit from lower labor costs and consumers may find lower prices for goods, but the manager also knows that the terminated employees, their families, and their communities will likely suffer from the loss of income. Yet if the employees terminated are near retirement and have sizable retirement savings or if the termination motivates employees to return to college and seek better jobs, the impact on them, their families, and their communities may be minimal or even positive. On the other hand, if the manager makes the decision to retain the employees, shareholder wealth may decrease and economic inefficiency may result, which harms all society.

Independent Boards of Directors In some of the instances in which corporate executives have acted unethically and violated the law, the board of directors was little more than a rubber stamp or a sounding board for the CEO and other top executives. The CEO handpicked a board that largely allowed the CEO to run the corporation with little board supervision.

CEO domination of the board is a reality in most large corporations, because the market for CEO talent has skewed the system in favor of CEOs. Few CEOs are willing to accept positions in which the board exercises real control. Often, therefore, a CEO determines which board members serve on the independent board nominating committee and selects who is nominated by the committee. Owing their positions to the CEO and earning handsome fees sometimes exceeding $100,000, many directors are indisposed to oppose the CEO's plans.

For more than three decades, corporate critics have demanded that corporate boards be made more nearly independent of the CEO. The corporate ethical crisis of recent years has increased those calls for independence. The New York Stock Exchange and NASDAQ require companies with securities listed on the exchanges to have a majority of directors independent of the company and top management. Their rules also require independent management compensation, board nomination, and audit committees. The Sarbanes–Oxley Act of 2002 requires public companies to have board audit committees comprising only independent directors.

One criticism of director independence rules is the belief that no director can remain independent after joining the board, because every director receives compensation from the corporation. There is a concern that an independent director, whose compensation is high, will side with management to ensure his continuing nomination, election, and receipt of high fees.

More extreme proposals of corporate critics include recommendations that all corporate stakeholders, such as labor, government, environmentalists, and communities, have representation on the board or that special directors or committees be given responsibility over special areas, such as consumer protection and workers' rights. Other critics argue for contested elections for each board vacancy. Few corporations have adopted these recommendations.

While honestly motivated, these laws and recommendations often fail to produce greater corporate social responsibility because they ignore the main reason for management's domination of the board: the limited time, information, and resources that directors have. One solution is to give outside directors a full-time staff with power to acquire information within the corporation. This solution, while providing a check on management, also may produce inefficiency by creating another layer of management in the firm.

In addition, some of the recommendations complicate management by making the board less cohesive. Conflicts between stakeholder representatives or between inside and outside directors may be difficult to resolve. For example, the board could be divided by disputes between shareholders who want more dividends, consumers who want lower prices, and employees who want higher wages.

Changing the Internal Management Structure Some corporate critics argue that the historic shift of corporate powers away from a public corporation's board and shareholders to its managers is irreversible. They recommend, therefore, that the best way to produce responsible corporate behavior is to change the corporation's management structure.

The main proponent of this view, Christopher Stone, recommended the creation of offices dedicated to areas such as environmental affairs and workers' rights, higher educational requirements for officers in positions like occupational safety, and procedures to ensure that important information inside and outside the corporation is directed to the proper person within the corporation. He also recommended that corporations study certain important issues and create reports of the study before making decisions.

These requirements aim to change the process by which corporations make decisions. The objective is to improve decision making by raising the competency of decision makers, increasing the amount of relevant information they hold, and enhancing the methodology by which decisions are made.

More information held by more competent managers using better tools should produce better decisions. Two of the later sections in this chapter in part reflect these recommendations. The Guidelines for Ethical Decision Making require a decision maker to study a decision carefully before making a decision. This includes acquiring all relevant facts, assessing a decision's impact on each stakeholder, and considering the ethics of one's decision from each ethical perspective. In addition, the Critical Thinking section below will help you understand when fallacious thinking interferes with a manager's ability to make good decisions.

Eliminating Perverse Incentives and Supervising Management Even if a corporation modifies its internal management structure by improving the decision-making process, there are no guarantees more responsible decisions will result. To the extent unethical corporate behavior results from faulty perception and inadequate facts, a better decision-making process helps. But if a decision maker is motivated solely to increase short-term profits, irresponsible decisions may follow. When one examines closely recent corporate debacles three things are clear: the corporate wrongdoers acted in their selfish interests; the corporate reward system encouraged them to act selfishly, illegally, and unethically; the wrongdoers acted without effective supervision. These facts suggest other changes that should be made in the internal management structure.

During the high flying stock market of the 1990s, stock options were the compensation package preferred by high level corporate executives. Shareholders and boards of directors were more than willing to accommodate them. On one level, stock options seem to align the interests of executives with those of the corporation and it shareholders. Issued at an exercise price usually far below the current market price of the stock, stock options have no value until the corporation's stock price exceeds the exercise price of the stock options. Thus, executives are motivated to increase the corporation's profits, which should result in an increase in the stock's market price. In the 1990s stock market, in which some stock prices were doubling yearly, the exercise price of executives' stock options was quickly dwarfed by the market price. Executives exercised the stock options, buying and then selling stock, and in the process generating profits for a single executive in the tens and hundreds of millions of dollars. Shareholders also benefited from the dramatic increase in the value of their stock.

So what is the problem with stock options? As executives accepted more of their compensation in the form of stock options and became addicted to the lifestyle financed by them, some executives felt pressure to keep profits soaring to ever higher levels. In companies like Enron and WorldCom, which had flawed business models and suspect accounting practices, some executives were encouraged to create business deals that had little if any economic justification and could be accounted for in ways that kept profits growing. In what were essentially pyramid schemes, once the faulty economics of the deals were understood by prospective partners, no new deals were possible and the schemes crashed like houses of cards. But until the schemes were discovered, many executives, including some who were part of the fraudulent schemes, pocketed tens and hundreds of millions of dollars in stock option profits.

The Sarbanes–Oxley Act of 2002 attempts to recover fraudulently obtained stock option profits by requiring the CEO and CFO to reimburse the company when the corporation is required to restate its financial statements filed with the SEC. The CEO and CFO must disgorge any bonus or stock compensation that was received within 12 months after a false financial report was filed with the SEC.

It is easy to see how fraudulent actions subvert the objective of stock options to motivate executives to act in the best interests of shareholders. Adolph Berle, however, has argued for more than 30 years that stock options are flawed compensation devices that allow executives to profit when stock market prices rise in general, even when executives have no positive effect on profitability. He proposed that the best way to compensate executives is to allow them to trade on inside information they possess about a corporation's prospects, information they possess because they helped produce those prospects. His proposal, however, is not likely ever to be legal compensation because insider trading creates the appearance that the securities markets are rigged.

Even with incentives in place to encourage executives to inflate profits artificially, it is unlikely that the recent fraudulent schemes at Enron, WorldCom, and other companies would have occurred had there been better scrutiny of upper management and its actions by the CEO and the board of directors. At Enron, executives were given great freedom to create partnerships that allowed Enron to keep liabilities off the balance sheet yet generate income that arguably could be recognized in the current period. It is not surprising that this freedom from scrutiny when combined with financial incentives to create the partnerships resulted in executives creating partnerships that had little economic value to Enron.

Better supervision of management is mostly the responsibility of the CEO, but the board of directors bears this duty also. We addressed earlier proposals to create boards of directors that are more nearly independent of the CEO and, therefore, better able to supervise the CEO and other top managers. Primarily, however, better supervision is a matter of attitude, or a willingness to devote time and effort to discover the actions of those under your charge and to challenge them to justify their actions. It is not unlike the responsibility a parent owes to a teenage child to scrutinize her actions and her friends to make sure that she is acting consistent with the values of the family. So too, boards must make the effort to scrutinize their CEOs and hire CEOs who are able and willing to scrutinize the work of the managers below them.

Yet directors must also be educated and experienced. Poor supervision of management has also been shown to be partly due to some directors' ignorance of business disciplines like finance and accounting. Unless board members are able to understand accounting numbers and other information that suggests management wrongdoing, board scrutiny of management is a process with no substance.

The Law The law has been a main means of controlling corporate misdeeds. Lawmakers usually assume that corporations and executives are rational actors that can be deterred from unethical and socially irresponsible behavior by the threats law presents. Those threats are fines and civil damages, such as those imposed and increased by the Sarbanes–Oxley Act of 2002. For deterrence to work, however, corporate decision makers must know when the law's penalties will be imposed, fear those penalties, and act rationally to avoid them.

To some extent, the law's ability to control executive misbehavior is limited. As we discussed earlier in this chapter, corporate lobbying may result in laws reflecting the views of corporations, not society as a whole. Some corporate executives may not know the law exists. Others may view the penalties merely as a cost of doing business. Some may think the risk of detection is so low that the corporation can avoid detection. Other executives believe they are above the law, that it does not apply to them out of arrogance or a belief that they know better than lawmakers. Some rationalize their violation of the law on the grounds that "everybody does it."

Nonetheless, for all its flaws, the law is an important means by which society controls business misconduct. Of all the devices for corporate control we have considered, only market forces and the law impose direct penalties for corporate misbehavior. Although legal rules have no special claim to moral correctness, at least they are knowable. Laws also are the result of an open political process in which competing arguments are made and evaluated. This cannot be said about the intuitions of a corporate ethics officer, edicts from public interest groups, or the theories of economists or philosophers, except to the extent they are reflected in law. Moreover, in mature political systems like the United States, respect for and adherence to law is a well-entrenched value.

Where markets fail to promote socially responsible conduct, the law can do the job. For example, the antitrust laws discussed in Chapters 48–50, while still controversial, have eliminated the worst anticompetitive business practices. The federal securities laws examined in Chapters 45 and 46 arguably restored investor confidence in the securities markets after the stock market crash of 1929. Although environmentalists often demand more regulation, the environmental laws treated in Chapter 52 have improved the quality of water and reduced our exposure to toxic substances. Employment regulations discussed in Chapter 51—especially those banning employment discrimination—have forced significant changes in the American workplace. Thus, the law has an accomplished record as a corporate control device.

Indeed, sometimes the law does the job too well, often imposing a maze of regulations that deter socially valuable profit seeking without producing comparable benefits. The Fed's Greenspan once wrote, "Government regulation is not an alternative means of protecting the consumer. It does not build quality into goods, or accuracy into information. Its sole 'contribution' is to substitute force and fear for incentive as the 'protector' of the consumer."

The hope was that the Sarbanes–Oxley Act of 2002 would restore investor confidence in audited financial statements and corporate governance. A 2005 survey by Approva Corporation found that 44 percent of finance executives perceived the Act as having net gains to investors, while 43 percent thought otherwise. Those results came despite the high cost of complying with the Act: $5 million for mid-size companies with revenues of $1 billion to

The Global Business Environment

Foreign Businesses Face Tougher Laws in U.S. than at Home

Although American executives accused of defrauding shareholders are prosecuted or hauled before congressional hearings, wrongdoing managers in the rest of the world often escape the grasp of their countries' regulators. In most of Asia, Europe, and Latin America, regulations and enforcement are weak. Some legal systems are poorly equipped to handle executive misconduct. The Japanese Securities and Exchange Surveillance Commission has only 360 employees and no power to file civil suits or bring administrative actions against corporate wrongdoers. It brings about seven cases a year, compared to the 50 usually brought by the United States Securities and Exchange Commission.

Taiwan's Securities and Futures Commission has no power to conduct its own investigations, and local prosecutors who do have that power have little expertise in market and accounting fraud. Germany has been labeled the Wild West, with numerous scandals in newly public companies, yet few actions against the perpetrators. The German Association for Shareholder Protections, a shareholder rights group, regularly brings abuse allegations to state prosecutors, yet the cases are often too complicated for untrained prosecutors to handle. Fewer than 5 percent are investigated. In Italy, false accounting was decriminalized in 2001, making it merely a misdemeanor.

Yet if those executives manage foreign businesses that register their securities on a stock exchange in the United States, such as the New York Stock Exchange, the Sarbanes–Oxley Act of 2002 requires them to comply with some of the Act's toughest provisions. More than 1,300 foreign corporations, such as Sony, Nokia, and Daimler Chrysler, and their executives are affected by the Act's provisions that ban loans to officers, require independent audit committees, and impose personal liability on officers for errors in the corporate books.

Foreign governments and businesses have lobbied to be granted exemptions from the Sarbanes–Oxley Act. The European Union wrote to U.S. legislators that the Act gives the SEC unjustified authority over foreign auditing firms that could chill trans-Atlantic trade. The EU warned that it may consider regulating American auditing firms. The president of the Japanese Institute of Certified Public Accountants argued that the Act places U.S. law above Japanese securities and CPA law, violates international treaties, and infringes Japanese sovereignty.

$4 billion. For larger companies, like General Electric, the cost is even higher. In 2004, GE spent $30 million to comply with just part of the Act, section 404, which requires verification of adequate internal controls.

Guidelines for Ethical Decision Making

Now that you understand the basics of ethical theories and the issues in the corporate governance debate, how do you use this information to make decisions for your business that are ethical and socially responsible? That is, what process will ensure that you have considered all the ethical ramifications and arrived at a decision that is good for your business, good for your community, good for society as a whole, and good for you.

Figure 1 lists nine factors in the Guidelines for Ethical Decision Making. Let's consider each Guideline and explain how each helps you make better decisions.

What Facts Impact My Decision? This is such an obvious component of any good decision that it hardly seems necessary to mention. Yet it is common that people make only a feeble attempt to acquire *all* the facts necessary to a good decision.

Many people enter a decision-making process biased in favor of a particular option. As a result, they look only for facts that support that option. You have seen this done many times by your friends and opponents, and since you are an honest person, you have seen yourself do this as well from time to time. In addition, demands on our time, fatigue, laziness, ignorance of where to look for facts, and aversion to inconvenience someone who has information contribute to a reluctance or inability to dig deep for relevant facts.

Since good decisions cannot be made in a partial vacuum of information, it is important to recognize when you need to acquire more facts. That is primarily the function of your other classes, which may teach you how to make stock market investment decisions, how to audit a company's financial records, and how to do marketing research.

For our purposes, let's consider this example. Suppose we work for a television manufacturing company that has a factory in Sacramento, California. Our company has placed you in charge of investigating the firm's decision whether to move the factory to Juarez, Mexico. What facts are needed to make this decision, and where do you find those facts?

Among the facts you need are: What are the firm's labor costs in Sacramento and what will those costs be

Figure 1 *Guidelines for Ethical Decision Making*

1. What **FACTS** impact my decision?
2. What are the **ALTERNATIVES**?
3. Who are the **STAKEHOLDERS**?
4. How do the alternatives impact **SOCIETY AS A WHOLE**?
5. How do the alternatives impact **MY BUSINESS FIRM**?
6. How do the alternatives impact **ME, THE DECISION MAKER**?
7. What are the **ETHICS** of each alternative?
8. What are the **PRACTICAL CONSTRAINTS** of each alternative?
9. What **COURSE OF ACTION** should be taken and how do we **IMPLEMENT** it?

in Juarez? How much will labor costs increase in subsequent years? What is the likelihood of good labor relations in each location? What is and will be the productivity level of employees in each city? What are and will be the transportation costs of moving the firm's inventory to market? What impact will the move have on employees, their families, the communities, the schools, and other stakeholders in each community? Will Sacramento employees find other jobs in Sacramento or elsewhere? How much will we have to pay in severance pay?

How will our customers and suppliers be impacted by our decision? If we move to Juarez, will our customers boycott our products even if our televisions are better and cheaper than before? If we move, will our suppliers' costs increase or decrease? How will our profitability be affected? How will shareholders view the decision? Who are our shareholders? Do we have a lot of Mexican shareholders, or do Americans dominate our shareholder list? What tax concessions and other benefits will the City of Sacramento give our firm if we promise to stay in Sacramento? What will Ciudad Juarez and the government of Mexico give us if we move to Juarez? How will our decision impact U.S.–Mexican economic and political relations?

This looks like a lot of facts, but we have only scratched the surface. You can probably come up with another 100 facts that should be researched. To give you another example of how thorough managers must be to make prudent decisions, consider that the organizers for the 2000 Summer Olympics in Sydney, Australia, created 800 different terrorist scenarios before developing an antiterrorism plan.

You can see that to some extent we are discussing other factors in the Guidelines as we garner facts. The factors do overlap to some degree. Note also that some of the facts you want to find are not facts at all, but estimates, such as cost and sales projections. We'll discuss in the Eighth Guideline the practical problems with the facts we find.

What Are the Alternatives?

A decision maker must be thorough in listing the alternative courses of actions. For many of us, the temptation is to conclude that there are only two options: to do something or not to do something. Let's take our decision whether to move our factory to Juarez, Mexico. You might think that the only choices are to stay in Sacramento or to move to Juarez. Yet there are several combinations that fall in between those extremes.

For example, we could consider maintaining the factory in Sacramento temporarily, opening a smaller factory in Juarez, and gradually moving production to Mexico as employees in Sacramento retire. Another alternative is to offer jobs in the Juarez factory to all Sacramento employees who want to move. If per-unit labor costs in Sacramento are our concern, we could ask employees in Sacramento to accept lower wages and fringe benefits or to increase their productivity.

There are many other alternatives that you can imagine. It is important to consider all reasonable alternatives. If you do not, you increase the risk that the best course of action was not chosen only because it was not considered.

Who Are the Stakeholders?

In modern societies, where diversity is valued as an independent virtue, considering the impacts of your decision on the full range of society's stakeholders has taken on great significance in prudent and ethical decision making. While a public

corporation with thousands of shareholders obviously owes a duty to its shareholders to maximize shareholder wealth, corporate managers must also consider the interests of other important stakeholders, including employees, suppliers, customers, and the communities in which they live. Stakeholders also include society as a whole, which can be defined as narrowly as your country or more expansively as an economic union of countries, such as the European Union of 15 countries, or even the world as a whole.

Not to be omitted from stakeholders is you, the decision maker who is also impacted by your decisions for your firm. The legitimacy of considering your own selfish interests will be considered fully in the Sixth Guideline.

Listing all the stakeholders is not a goal by itself, but helps the decision maker apply more completely other factors in the Ethical Guidelines. Knowing whom your decision affects will help you find the facts you need. It also helps you evaluate the alternatives using the next three Guidelines: how the alternatives we have proposed impact society as whole, your firm, and the decision maker.

How Do the Alternatives Impact Society as a Whole? We covered some aspects of this Guideline above when we made an effort to discover all the facts that impact our decision. We can do a better job discovering the facts if we try to determine how our decision impacts society as a whole.

For example, if the alternative we evaluate is keeping the factory in Sacramento after getting property tax and road building concessions from the City of Sacramento, how is society as a whole impacted? What effect will tax concessions have on the quality of Sacramento schools (most schools are funded with property taxes)? Will lower taxes cause the Sacramento infrastructure (roads and governmental services) to decline to the detriment of the ordinary citizen? Will the economic benefits to workers in Sacramento offset the harm to the economy and workers in Juarez?

Will our firm's receiving preferential concessions from the Sacramento government undermine the ordinary citizen's faith in our political and economic institutions? Will we contribute to the feelings of some citizens that government grants privileges only to the powerful? Will our staying in Sacramento foster further economic growth in Sacramento? Will staying in Sacramento allow our suppliers to stay in business and continue to hire employees who will buy goods from groceries and malls in Sacramento?

What impact will our decision have on efforts to create a global economy in which labor and goods can freely travel between countries? Will our decision increase international tension between the United States and Mexico?

Note that the impact of our decision on society as a whole fits neatly with one of the ethical theories we discussed earlier: utilitarianism. Yet profit maximization, rights theory, and justice theory also require a consideration of societal impacts.

How Do the Alternatives Impact My Firm? The most obvious impact any alternative has on your firm is its effect on the firm's bottom line: what are the firm's profits. Yet that answer requires explaining, because what you really want to know is what smaller things leading to profitability are impacted by an alternative.

For example, if our decision is to keep the factory in Sacramento open temporarily and gradually move the plant to Juarez as retirements occur, what will happen to employee moral and productivity in Sacramento? Will our suppliers in Sacramento abandon us to serve more permanent clients instead? Will consumers in Sacramento and the rest of California boycott our televisions? Will they be able to convince other American laborers to boycott our TVs? Will a boycott generate adverse publicity and media coverage that will damage our brand name? Will investors view our firm as a riskier business, raising our cost of capital?

Again, you can see some redundancy here as we work through the guidelines, but that redundancy is all right, for it ensures that we are examining all factors important to our decision.

How Do the Alternatives Impact Me, the Decision Maker? At first look, considering how a decision you make for your firm impacts *you* hardly seems to be a component of ethical and responsible decision making. The term "selfish" probably comes to mind.

Many of the corporate ethical debacles of the last few years comprised unethical and imprudent decisions that probably were motivated by the decision makers' selfish interests. Several of Enron's off-balance-sheet partnerships, while apparently helping Enron's financial position, lined the pockets of conflicted Enron executives holding stock options and receiving management fees from the partnerships. WorldCom's decision to seek more and larger acquisition targets was in part motivated by some executives' selfish goal to maintain a high stock price that made their stock options valuable.

Despite these examples, merely because a decision benefits you, the decision maker, does not always mean it is imprudent or unethical. Even decisions by some Enron executives in the late 1990s, while motivated in part by the desire to increase the value of the executives' stock options, could have been prudent and ethical if the off-balance-sheet partnerships had real economic value to Enron (as they did when Enron first created off-balance-sheet partnerships in the 1980s) and accounting for them complied with the law.

At least two reasons explain why you can and should consider your own interest yet act ethically for your firm. First, as the decision maker, you are impacted by the decision. Whether deservedly or not, the decision maker is often credited or blamed for the success or failure of the course of action chosen. You may also be a stakeholder in other ways. For example, if you are an executive in the factory in Sacramento, you and your family may be required to move to Juarez (or El Paso, Texas, which borders Juarez) if the factory relocates. It is valid to consider a decision's impact on you and your family, although it should not be given undue weight.

A second, and more important, reason to consider your own interest is that your decision may be better for your firm and other stakeholders if you also consider your selfish interest. For example, suppose when you were charged to lead the inquiry into the firm's decision whether to move to Juarez, it was made clear that the CEO preferred to close the Sacramento factory and move operations to Juarez.

Suppose also that you would be required to move to Juarez. Your spouse has a well-paying job in Sacramento, and your teenage children are in a good school system and have very supportive friends. You have a strong relationship with your parents and siblings, who also live within 50 miles of your family in Sacramento. You believe that you and your family could find new friends and good schools in El Paso or Juarez, and the move would enhance your position in the firm and increase your chances of a promotion. Nonetheless, overall you and your spouse have determined that staying in the Sacramento area is best for your family. So you are considering quitting your job with the firm and finding another job in the Sacramento area rather than make an attempt to oppose the CEO's preference.

If you quit your job, even in protest, you will have no role in the decision and your resignation will likely have no impact on the firm's Sacramento–Juarez decision. Had you stayed with the firm, you could have led a diligent inquiry into all the facts that may have concluded that the prudent and ethical decision for the firm was to stay in Sacramento. Without your input and guidance, the firm may make a less prudent and ethical decision.

You can think of other examples where acting selfishly also results in better decisions. Suppose a top-level accounting executive, to whom you are directly responsible, has violated accounting standards and the law by pressuring the firm's auditors to book as income in the current year a contract that will not be performed for two years. You could quit your job and blow the whistle, but you may be viewed as a disgruntled employee and your story given no credibility. You could confront the executive, but you may lose your job or at least jeopardize your chances for a promotion while tipping off the executive, who will cover her tracks. As an alternative, the more effective solution may be to consider how you can keep your job and prospects for promotion while achieving your objective to blow the whistle on the executive. One alternative may be to go through appropriate channels in the firm, such as discussing the matter with the firm's audit committee or legal counsel.

Finding a way to keep your job will allow you to make an ethical decision that benefits your firm, whereas your quitting may leave the decision to someone else who would not act as prudently. The bottom line is this: while sometimes ethical conduct requires acting unselfishly, in other contexts consideration of your self-interest is not only consistent with ethical conduct, but also necessary to produce a moral result.

What Are the Ethics of Each Alternative?

Because our goal is to make a decision that is not only prudent for the firm but also ethical, we must consider the ethics of each alternative, not from one but a variety of ethical viewpoints. Our stakeholders' values comprise many ethical theories; ignoring any one theory will likely cause an incomplete consideration of the issues and may result in unforeseen consequences.

What Would a Utilitarian Do? A utilitarian would choose the alternative that promises the highest net welfare to society as a whole. If we define our society as the United States, moving to Juarez may nonetheless produce the highest net benefit, because the benefits to American citizens from a lower cost of televisions and to American shareholders from higher profits may more than offset the harm to our employees and other citizens of Sacramento. Another benefit of the move may be the reduced cost of the American government dealing with illegal immigration as Mexican workers decide to work at our plant in Juarez. Another cost may be the increased labor cost for a Texas business that would have hired Mexican workers had we not hired them.

If we define society as all countries in the North American Free Trade Agreement (NAFTA was signed by the United States, Mexico, and Canada), the benefit to workers in Juarez may completely offset the harm to workers in Sacramento. For example, the benefit to Juarez workers may be greater than the harm to Sacramento employees if many Juarez employees would otherwise be underemployed and Sacramento employees can find other work or are protected by a severance package or retirement plan.

As we discussed above in the discussion of ethical theories, finding and weighing all the benefits and costs of an alternative are difficult tasks. Even if we reject this theory as the final determinant, it is a good exercise for ensuring that we maximize the number of facts we consider when making a decision.

What Would a Profit Maximizer Do? A profit maximizer will choose the alternative that produces the most long-run profits for the company, within the limits of the law. This may mean, for example, that the firm should keep the factory in Sacramento if that will produce the most profits for the next 10 to 15 years.

This does not mean that the firm may ignore the impact of the decision on Juarez's community and workers. It may be that moving to Juarez will create a more affluent population in Juarez and consequently increase the firm's television sales in Juarez. But that impact is judged not by whether society as a whole is bettered (as with utilitarian analysis) or whether Juarez workers are more deserving of jobs (as with justice theory analysis), but is solely judged by how it impacts the firm's bottom line.

Nonetheless, profit maximization compels a decision maker to consider stakeholders other than the corporation and its shareholders. A decision to move to Juarez may mobilize American consumers to boycott our TVs, for example, or cause a public relations backlash if our Juarez employees receive wages far below our Sacramento workers. These and other impacts on corporate stakeholders may negatively impact the firm's profits.

Although projecting profits is not a precise science, tools you learned in finance classes should enhance your ability to select an alternative that maximizes your firm's profits within the limits of the law.

What Would a Rights Theorist Do? A follower of modern rights theory will determine whether anyone's rights are negatively affected by an alternative. If several rights are affected, the rights theorist will determine which right is more important or trumps the other rights, and choose the alternative that respects the most important right.

For example, if the alternative is to move to Juarez, the Sacramento employees, among others, are negatively affected. Yet if we do not move, potential employees in Juarez are harmed. Are these equal rights, a mere wash, or is it more important to retain a job one already has than to be deprived of a job one has never had?

Are other rights at work here, and how are they ranked? Is it more important to maintain manufacturing production in the firm's home country for national security and trade balance reasons than to provide cheaper televisions for the firm's customers? Does the right of all citizens to live in a global economy that spreads wealth worldwide and promotes international harmony trump all other rights?

While apparently difficult to identify and rank valid rights, this theory has value even to a utilitarian and a profit maximizer. By examining rights that are espoused by various stakeholders, we are more likely to consider all the costs and benefits of our decision and know which rights can adversely affect the firm's profitability if we fail to take them into account.

What Would a Justice Theorist Do? A justice theorist would choose the alternative that allocates society's benefits and burden most fairly. This requires the decision maker to consider whether everyone is getting what he deserves. If we follow the preaching of John Rawls, the firm should move to Juarez if the workers there are less advantaged than those in Sacramento, who may be protected by savings, severance packages, and retirement plans.

If we follow Nozick's libertarian approach, it is sufficient that the firm gives Sacramento workers an opportunity to compete for the plant by matching the offer the firm has received from Juarez workers. Under this analysis, if Sacramento workers fail to match the Juarez workers' offer of lower wages, for example, it would be fair to move the factory to Juarez, even if Sacramento workers are denied their right to jobs.

Even if the firm has difficulty determining who most deserves jobs with our firm, justice theory, like rights theory, helps the firm identify constituents who suffer from our decision and who can create problems impacting the firm's profitability if the firm ignores their claims.

What Are the Practical Constraints of Each Alternative?

As we evaluate alternatives, it is important to consider each alternative's practical problems before we implement it. For example, is it feasible for us to implement an alternative? Do we have the necessary money, labor, and other resources?

Suppose one alternative is to maintain our manufacturing plant in Sacramento as we open a new plant in Juarez, gradually shutting down the Sacramento plant as employees retire and quit. That alternative sounds like an ethical way to protect the jobs of all existing and prospective employees, but what are the costs of having two plants? Will the expense make that alternative infeasible? Will the additional expense make it difficult for the firm to compete with other TV manufacturers? Is it practicable to have a plant in Sacramento operating with only five employees who are 40 years old and will not retire for 15 years?

It is also necessary to consider potential problems with the facts that have led us to each alternative. Did we find all the facts relevant to our decision? How certain are we of some facts? For example, are we confident about our projections of labor and transportation costs if we move to Juarez? Are we sure that sales of our products will drop insubstantially due to consumer boycotts?

What Course of Action Should Be Taken and How Do We Implement It?

Ultimately, we have to stop our analysis and make a decision by choosing one alternative. Yet even then our planning is not over.

We must determine how to put the alternative into action. How do we implement it? Who announces the decision? Who is told of the decision and when? Do some people, like our employee's labor union, receive advance notice of our plans and have an opportunity to negotiate a better deal for our Sacramento employees? When do we tell shareholders, government officials, lenders, suppliers, investments analysts, and the media and in what order? Do we antagonize a friend or an enemy and risk killing a deal if we inform someone too soon or too late?

Finally, we have to prepare for the worst-case scenario. What do we do if, despite careful investigation, analysis, and planning, our course of action fails? Do we have backup plans? Have we anticipated all the possible ways our plan may fail and readied responses to those failures?

Nearly two decades ago, The Coca-Cola Company decided to change the flavor of Coke in response to Coke's shrinking share of the cola market. Despite careful market research, Coca-Cola failed to anticipate Coke drinkers' negative response to the new Coke formula and was caught without a response to the outcry. Within three months, Coca-Cola realized it had to revive the old Coke formula under the brand name Coca-Cola Classic. In the meantime, Coke lost significant market share to rival Pepsi. Today, one would expect Coke executives introducing a reformulated drink to predict more consumers' reactions to the drink and to prepare a response to each reaction.

Knowing When to Use the Guidelines

You can probably see that following these factors will result in better decisions in a variety of contexts, including some that appear to have no ethical concerns. For example, in the next few years, most of you will consider what major course of study to select at college or what job to take with which firm in which industry. This framework can help you make a better analysis that should result in a better decision.

The Guidelines can be used also to decide mundane matters in your personal life, such as whether to eat a high-fat hamburger or a healthful salad for lunch, whether to spend the next hour exercising at the gym or visiting a friend in the hospital, and whether or not to brush your teeth every day after lunch. But for most of us, using the Guidelines every day for every decision would occupy so much of our time that little could be accomplished, what is sometimes called "paralysis by analysis."

Practicality, therefore, requires us to use the Guidelines only for important decisions and those that create a potential for ethical problems. We can identify decisions requiring application of the Guidelines if we carefully reflect from time to time about what we have done and are doing. This requires us to examine our past, current, and future actions.

It may not surprise you how seldom people, including business executives, carefully preview and review their actions. The pressures and pace of daily living give us little time to examine our lives critically. Most people are reluctant to look at themselves in the mirror and ask themselves whether they are doing the right thing for themselves, their families, their businesses, and their communities. Few know or follow the words of Socrates, "The unexamined life is not worth living."

Ask yourself whether you believe that executives at bankrupt energy trader Enron used anything like the Guidelines for Ethical Decision Making before creating off-balance-sheet partnerships with no economic value to Enron. Do you think the employees at accounting firm Arthur Andersen carefully examined their decision to accept Enron's accounting for off-balance-sheet partnerships? Did those in charge at Andersen review their decision to order the shredding of evidence in light of the Ethical Guidelines? Did the CEO and other insiders at ImClone consider any ethical issues before trading on confidential, nonpublic information that the FDA had denied approval of a new ImClone drug?

Merely by examining our past and prospective actions, we can better know when to apply the Guidelines. In the last section of this chapter, Resisting Requests to Act Unethically, you will learn additional tools to help you identify when to apply the Guidelines.

LOG ON

Go to **www.ethics.ubc.ca/**

This Web site maintained by The W. Maurice Young Centre for Applied Ethics at the University of British Columbia has links to business ethics resources and guides for ethical/moral decision making.

Thinking Critically

Part of ethical decision making is being able to think critically, that is, to evaluate arguments logically, honestly, and without bias in favor of your own arguments and against those of others.

Even if someone uses the Guidelines for Ethical Decision Making, there is a risk that they have been misapplied if a person makes errors of logic or uses fallacious arguments. In this section, we want to help you identify when your arguments and thinking may be flawed and how to correct them. Equally important, we want to help you identify flaws in others' thinking. The purpose is to help you think critically and not to accept at face value everything you read or hear and to be careful before you commit your arguments to paper or voice them.

This chapter's short coverage of critical thinking covers only a few of the errors of logic and argument that are covered in a college course or book devoted to the subject. Here are 15 common fallacies.

Non Sequiturs

A *non sequitur* is a conclusion that does not follow from the facts or premises one sets out. The speaker is missing the point or coming to an irrelevant conclusion. For example, suppose a consumer uses a corporation's product and becomes ill. The consumer argues that because the corporation has lots of money, the corporation should pay for his medical expenses. Clearly, the consumer is missing the point. The issue is whether the corporation's product *caused* his injuries, not whether money should be transferred from a wealthy corporation to a poor consumer.

You see this also used when employees attempt to justify stealing pens, staplers, and paper from their employers. The typical *non sequitur* goes like this: "I don't get paid enough, so I'll take a few supplies. My employer won't even miss them."

Business executives fall prey to this fallacy also. Our firm may consider which employees to let go during a downturn. Company policy may call for retaining the best employees in each department, yet instead we release those employees making the highest salary in each position in order to save more money. Our decision does not match the standards the company set for downsizing decisions and is a *non sequitur,* unless we admit that we have changed company policy.

Appeals to Pity

A common fallacy seen in the American press is the appeal to pity or compassion. This argument generates support for a proposition by focusing on a victim's predicament. It usually is also a *non sequitur*. Examples are antismoking advertisements that focus on the physical miseries (such as cancer and emphysema) of cigarette smokers and the impact on their families, especially children. None of those ads point out that many ill smokers knew the harms of tobacco before they started smoking.

Appeals to pity are effective because humans are compassionate. We have to be careful, however, not to be distracted from the real issues at hand. For example, in the trial against accused 9/11 co-conspirator Zacarias Moussaoui, federal prosecutors wanted to introduce testimony by the families of the victims. While what the families of 9/11 suffered is terrible, the victims' families hold no evidence of Moussaoui's role in 9/11. Instead, their testimonies are appeals to pity likely to distract the jury from its main task of determining whether Moussaoui was a part of the 9/11 conspiracy.

You see many appeals to pity used against corporations. Here is a typical argument: a corporation has a chemical plant near a neighborhood; children are getting sick and dying in the neighborhood; someone should pay for this suffering; the corporation should pay. You can also see that this reasoning is a *non sequitur*. Better reasoning requires one to determine not whether two events are coincidental or correlated, but whether one (the chemical plant) caused the other (the children's illnesses).

False Analogies

An analogy essentially argues that since something is like something else in one or more ways, it is also like it in another respect. Arguers often use analogies to make a point vividly, and therefore analogies have strong appeal. Nonetheless, while some analogies are apt, we should make sure that the two situations are sufficiently similar to make the analogy valid.

Suppose an executive argues that our firm should not create any off-balance-sheet partnerships, because the company will become bankrupt just like Enron. This analogy may be invalid because our off-balance-sheet partnerships may have real economic value, we may be motivated by a desire to reduce our risk and not to misstate our financial position, and we may be committed to recognize income from the partnerships only after we receive cash from customers.

Analogies can also be used to generate support for a proposal, such as arguing that since Six Sigma worked for General Electric, it will work for our firm also. It is probable that factors other than Six Sigma contributed to GE's success during the Jack Welch era, factors our firm may or may not share with GE.

Nonetheless, analogies can identify potential opportunities, which we should evaluate prudently to determine whether the analogy is valid. Analogies can also suggest potential problems that require us to examine a decision more carefully before committing to it.

Begging the Question

An arguer begs the question when she takes for granted or assumes the thing that she is setting out to prove. For example, you might say that we should tell the truth because lying is wrong. That is **circular reasoning** and makes no sense, because telling the truth and not lying are the same things. Another example is arguing that democracy is the best form of government because the majority is always right.

Examples of begging the question are difficult to identify sometimes because they are hidden in the language of the speaker. It is best identified by looking for arguments that merely restate what the speaker or questioner has already stated, but in different words. For an example in the business context, consider this interchange between you and someone working under you.

You: Can I trust these numbers you gave to me?

Co-worker: Yes, you can trust them.

You: Why can I trust them?

Co-worker: Because I'm an honest person.

The co-worker used circular reasoning, since whether the numbers can be trusted is determined by whether he is honest, yet he provided no proof of his honesty or trustworthiness.

Argumentum ad Populum

Argumentum ad populum means argument to the people. It is an emotional appeal to popular beliefs, values, or wants. The fallacy is that merely because many or all people believe something does not mean it is true. It is common for newspapers to poll its readers about current issues, such as support for a presidential decision. For example, a newspaper poll may show that 60 percent of Americans support the president. The people may be right, but it is also possible that the president's supporters are wrong: they may be uninformed or base their support of the president on invalid reasoning.

Arguments to the people are commonly used by corporations in advertisements, such as beer company ads showing friends having a good time while drinking beer. The point of such ads is that if you want to have a good time with friends, you should drink beer. While some beer drinkers do have fun with friends, you probably can also point to other people who drink beer alone.

Bandwagon Fallacy

The bandwagon fallacy is similar to *argumentum ad populum*. A bandwagon argument states that we should or should not do something merely because one or more other people or firms do or do not do it. A June 2002 issue of *Sports Illustrated* quoted baseball player Ken Caminiti's justification for using steroids: "At first I felt like a cheater. But I looked around, and everyone was doing it." Some people justify cheating on their taxes for the same reason.

This reasoning can be fallacious because probably not everyone is doing it, and even if many or all people do something, it is not necessarily right. For example, while some baseball players do use steroids, there are serious negative side effects including impotency and acute psychosis, which make its use risky. Cheating on taxes may be common, but it is still illegal and can result in the cheater's imprisonment. Business executives often jump on the bandwagon when they adopt a management tactic used by other corporations without investigating whether the tactic is right for their firm.

Argumentum ad Baculum

Argumentum ad baculum means argument to club. The arguer uses threats or fear to bolster his position. This is a common argument in business and family settings. For example, when a parent asks a child to take out the garbage, the child may ask, "Why?" Some parents respond, "Because if you don't, you'll spend the rest of the afternoon in your room." Such an argument is a *non sequitur* as well.

In the business context, bosses explicitly and implicitly use the club, often generating support for their ideas from subordinates who fear they will not be promoted unless they support the boss's plans. An executive who values input from subordinates will ensure that they do not perceive that the executive is wielding a club over them.

Enron's CFO Andrew Fastow used this argument against investment firm Goldman Sachs when it balked at lending money to Enron. He told Goldman that he would not do anything with a presentation Goldman had prepared unless it made the loan.

By threatening to boycott a company's products, consumers and other interest groups use this argument against corporations perceived to act unethically. It is one reason that profit maximization requires decision makers to consider a decision's impact on all stakeholders.

Argumentum ad Hominem

Argumentum ad hominem means "argument against the man." This tactic attacks the speaker, not his reasoning. For example, a Republican senator criticizes a Democratic senator who opposes the use of force to oust a dictator in the Middle East by saying, "You can't trust him. He never served in the armed forces." Such an argument attacks the Democratic senator's character, not the validity of his reasons for not ousting the dictator.

When a CEO proposes a new compensation plan for corporate executives, an opponent may argue, "Of course he wants the new plan. He'll make a lot of money from it." Again, this argument doesn't address whether the plan is a good one or not; it only attacks the CEO's motives. While the obvious conflict of interest the CEO has may cause us to doubt the sincerity of the reasons he presents for the plan (such as to attract and retain better management talent), merely pointing out this conflict does not rebut his reasons.

One form of *ad hominem* argument is attacking a speaker's consistency, such as, "Last year you argued for something different." Another common form is appealing to personal circumstances. One woman may say to another, "As a woman, how can you be against corporate policies that set aside executive positions for women?" By personalizing the argument, the speaker is trying to distract the listener from the real issue. A proper response to the personal attack may be, "As a women and a human, I believe in equal opportunity for all people. I see no need for any woman or myself to have special privileges to compete with men. I can compete on my own. By having quotas, the corporation cheapens my accomplishments by suggesting that I need the quota. Why do you, as a woman, think you need a quota?"

Guilt by association is the last *ad hominem* argument we will consider. This argument attacks the speaker by linking her to someone unpopular. For example, if you make the libertarian argument that government should not restrict or tax the consumption of marijuana, someone may attack you by saying, "Mass murderer Charles Manson also believed that." Your attacker suggests that by believing as you do, you are as evil as Charles Manson. Some corporate critics use guilt by association to paint all executives as unethical people motivated to cheat their corporations. For example, if a CEO asks for stock options as part of her compensation package, someone may say, "Enron's executives wanted stock options also." The implication is that the CEO should not be trusted because some Enron executives who were corrupt also wanted stock options.

No *ad hominem* argument is necessarily fallacious, because a person's character, motives, consistency, personal characteristics, and associations may suggest further scrutiny of a speaker's arguments is necessary. However, merely attacking the speaker does not expose flaws in her arguments.

Argument from Authority

Arguments from authority rely on the quality of an expert or person in a position of authority, not the quality of the expert's or authority's argument. For example, if someone says, "The president says we need to stop drug trafficking in the United States, and that is good enough for me," he has argued from authority. He and the president may have good reasons to stop drug trafficking, but we cannot know that from his statement.

Another example is "Studies show that humans need to drink 10 glasses of water a day." What studies? What were their methodologies? Did the sample sizes permit valid conclusions? A form of argument to authority is **argument to reverence or respect,** such as "Who are you to disagree with the CEO's decision to terminate 5,000 employees?" The arguer is trying to get you to abandon your arguments, not because they are invalid, but because they conflict with the views of an authority. Your response to this question should not attack the CEO (to call the CEO an idiot would be *ad hominem* and also damage your prospects in the firm), but state the reasons you believe the company would be better off not terminating 5,000 employees.

It is natural to rely on authorities who have expertise in the area on which they speak. But should we give credibility to authorities speaking on matters outside the scope of their competency? For example, does the fact that Julia Roberts is an Academy Award–winning actress have any relevance when she is testifying before Congress about Rett Syndrome, a neurological disorder that leaves infants unable to communicate and control body functions? Is she any more credible as a Rett Syndrome authority because she narrated a film on the Discovery Health Channel about children afflicted with the disease?

This chapter includes several examples of arguments from authority when we cite Kant, Bentham, and others who have formulated ethical theories. What makes their theories valid, however, is not whether they are recognized as experts, but whether their reasoning is sound.

False Cause

This fallacy results from observing two events and concluding that there is a causal link between them when there is no such link. Often we commit this fallacy because we do not attempt to find all the evidence proving or disproving the causal connection. For example, if as a store manager you change the opening hour for your store to 6 A.M. from 8 A.M., records for the first month of operation under the new hours may show an increase in revenue. While you may be tempted to infer that the revenue increase is due to the earlier opening hour, you should not make that conclusion until at the very least you examine store receipts showing the amount of revenue generated between 6 A.M. and 8 A.M.

The fallacy of false cause is important to businesses, which need to make valid connections between events in order to judge the effectiveness of decisions. Whether, for example, new products and an improved customer relations program increases revenues and profits should be subjected to rigorous testing, not some superficial causal analysis. Measurement tools you learn in other business classes help you eliminate false causes.

The Gambler's Fallacy

This fallacy results from the mistaken belief that independent prior outcomes affect future outcomes. Consider this example. Suppose you flip a coin five times and each time it comes up heads. What is the probability that the next coin flip will be heads? If you did not answer 50 percent, you committed the gambler's fallacy. Each coin flip is an independent event, so no number of consecutive flips producing heads will reduce the likelihood that the next flip will also be heads. That individual probability is true even though the probability of flipping six consecutive heads is 0.5 to the sixth power, or only 1.5625 percent.

What is the relevance of the gambler's fallacy to business? We believe and are taught that business managers and professionals with higher skills and better decision-making methods are more likely to be successful than those with lesser skills and worse methods. Yet we have not discussed the importance of luck or circumstance to success. When a corporation has five years of profits rising by 30 percent, is it due to good management or because of expanding consumer demand or any number of other reasons? If a mutual fund has seven years of annual returns of at least 15 percent, is the fund's manager an investment genius or is she lucky? If it is just luck, one should not expect the luck to continue. The point is that you should not be seduced by a firm's, manager's, or even your own string of successes and immediately jump to the conclusion that the successes were the result of managerial excellence. Instead, you should use measurement tools taught in your finance, marketing, and other courses to determine the real reasons for success.

Reductio ad Absurdum

Reductio ad absurdum carries an argument to its logical end, without considering whether it is an inevitable or probable result. This is often called the **slippery slope fallacy.**

For example, if I want to convince someone not to eat fast food, I might argue, "Eating fast food will cause you to put on weight. Putting on weight will make you overweight. Soon you will weigh 400 pounds and die of heart disease. Therefore, eating fast food leads to death. Don't eat fast food." In other words, if you started eating fast food, you are on a slippery slope and will not be able to stop until you die. Although you can see that this argument makes some sense, it is absurd for most people who eat fast food.

Scientist Carl Sagan noted that the slippery slope argument is used by both sides of the abortion debate. One side says, "If we allow abortion in the first weeks of pregnancy, it will be impossible to prevent the killing of a full-term infant." The other replies, "If the state prohibits abortion even in the ninth month, it will soon be telling us what to do with our bodies around the time of conception."

Business executives face this argument frequently. Human resource managers use it to justify not making exceptions to rules, such as saying, "If we allow you time off to go to your aunt's funeral, we have to let anyone off anytime they want." Well, no, that was not what you were asking for. Executives who reason this way often are looking for administratively simple rules that do not require them to make distinctions. That is, they do not want to think hard or critically.

Pushing an argument to its limits is a useful exercise in critical thinking, often helping us to discover whether a claim has validity. The fallacy is carrying the argument to its extreme without recognizing and admitting that there are many steps along the way that are more likely consequences.

Appeals to Tradition

Appeals to tradition infer that because something has been done a certain way in the past, it should be done the same way in the future. You probably have heard people say, "I don't know why we do it, but we've always done it that way, and it's always worked, so we'll continue to do it that way." Although

there is some validity to continuing to do what has stood the test of time, the reasons a business strategy has succeeded in the past may be independent of the strategy itself. The gambler's fallacy would suggest that perhaps we have just been lucky in the past. Also, changed circumstances may justify departing from previous ways of doing business.

The Lure of the New

The opposite of appeals to tradition is the lure of the new, the idea that we should do or buy something merely because it is "just released" or "improved." You see this common theme in advertising that promotes "new and improved" Tide or Windows 2005. Experience tells us that sometimes new products are better. But we can also recount examples of new car models with defects and new software with bugs that were fixed in a later version.

The lure of the new is also a common theme in management theories, as some managers have raced to embrace one new craze after another, depending on which is the hottest fad, be it Strategic Planning, Total Quality Management, Reengineering the Corporation, or Six Sigma. The point here is the same. Avoid being dazzled by claims of newness. Evaluations of ideas should be based on substance.

Sunk Cost Fallacy

The sunk cost fallacy is an attempt to recover invested time, money, and other resources, by spending still more time, money, or other resources. It is sometimes expressed as "throwing good money after bad." Stock market investors do this often. They invest $30,000 in the latest tech stock. When the investment declines to $2,000, rather than evaluate whether it is better to withdraw that $2,000 and invest it elsewhere, an investor who falls for the sunk cost fallacy might say, "I can't stop investing now, otherwise what I've invested so far will be lost." While the latter part of the statement is true, the fallacy is in the first part. Of the money already invested, $28,000 is lost whether or not the investor continues to invest. If the tech stock is not a good investment *at this time,* the rational decision is to withdraw the remaining $2,000 and not invest more money.

There are other statements that indicate business executives may fall victim to the sunk cost fallacy: "It's too late for us to change plans now." Or "If we could go back to square one, then we could make a different decision." The best way to spend the firm's remaining labor and money may be to continue a project. But that decision should be unaffected by a consideration of the labor and money already expended. The proper question is this: What project will give the firm the best return on its investment of money and other resources *from this point forward.* To continue to invest in a hopeless project is irrational, and may be a pathetic attempt to delay having to face the consequences of a poor decision.

A decision maker acts irrationally when he attempts to save face by throwing good money after bad. If you want a real-world example of ego falling prey to the sunk cost fallacy, consider that President Lyndon Johnson committed American soldiers to the Vietnam Conflict after he had determined that America and South Vietnam could never defeat the Viet Cong. By falling for the sunk cost fallacy, the United States lost billions of dollars and tens of thousands of soldiers in the pursuit of a hopeless cause.

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Maintained by Gary Curtis, *The Fallacy Files* cover more than 150 fallacies. With links to explanations and valuable resources.

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www.austhink.org/critical
Tim van Gelder's *Critical Thinking on the Web* lists some of the best Web sites with information about reasoning and critical thinking.

Common Characteristics of Poor Decision Making

Most business managers during the course of their formal education in school or informal education on the job have learned most of the techniques we have discussed in this chapter for making ethical and well-reasoned decisions. Yet business managers continue to make unethical and poor decisions, most often in disregard of the very principles that they otherwise view as essential to good decision making. Each of us can also point to examples when we have failed to analyze a situation properly before making a decision, even though at the time we possessed the ability to make better decisions.

Why do we and other well-intentioned people make bad decisions? What is it that interferes with our ability to use all the decision-making tools at our disposal, resulting sometimes in unethical and even catastrophic decisions? What causes a basically honest accountant to agree to cook the books for his corporation? What causes a drug company to continue to market a drug when internal tests and user experience show a high incidence of harmful side effects? What causes a corporation to continue to operate a chemical plant when its safety systems

have been shut down? While business scholars and other writers have suggested several attributes that commonly interfere with good decision making, we believe they can be distilled into three essential traits that are useful to you, a decision maker who has already learned the Guidelines for Ethical Decision Making and the most common critical thinking errors.

Failing to Remember Goals

Friedrich Nietzsche wrote, "Man's most enduring stupidity is forgetting what he is trying to do." If, for example, our company's goal as a retailer is to garner a 30 percent market share in the retail market in five years, you may think that would translate into being dominant in each segment of our business, from housewares to video games. But should our retailer strive to dominate a market segment that is declining, such as portable cassette players, when the consumer market has clearly moved to iPods and other similar digital recorders? If we focus on the wrong goal—dominating the cassette player market, which may not exist in five years—we have failed to remember our goal of acquiring a 30 percent overall market share.

In another example, suppose we are a luxury homebuilder with two goals that go hand-in-hand: producing high quality housing and maintaining an annual 15 percent return on equity. The first goal supports the second goal: by having a reputation for producing high quality housing, we can charge more for our houses. Suppose, however, one of our project managers is under pressure to bring her development in line with cost projections. She decides, therefore, to use lower quality, lower cost materials. The consequence is we meet our profit target in the short run, but in the long run when the shoddy materials are detected and our reputation is sullied, both of our goals of building high quality housing and achieving a 15 percent return on equity will be compromised. Again, we have failed to remember the most important goal, maintaining high quality, which allowed us to achieve our ROE goal.

Overconfidence

While confidence is a personal trait essential to success, overconfidence or overoptimism is one of the most common reasons for bad decisions. We all have heard ourselves and others say, "Don't worry. Everything will work out OK." That statement is likely a consequence of overconfidence, not careful analysis that is necessary to make sure everything will work out as we hope.

There are several corollaries or other ways to express this overoptimism. Sometimes businesses executives will do something that they know to be wrong with the belief that it is only a small or temporary wrong that will be fixed next year. They may rationalize that no one will notice the wrongdoing and that only big companies and big executives get caught, not small companies and little managers like them.

Many of the accounting scandals of the last ten years started small, rationalized as temporary attempts to cook the books that would be corrected in the following years when business turned around. As we now know, finance managers and accountants who thought things would turn around were being overconfident about the economy and their companies.

Another aspect of overconfidence is confirmation bias; that is, we must be doing things the right way because all has gone well in the past. Or at least we have not been caught doing something wrong in the past, so we will not be caught in the future. In part this reveals a thinking error we have studied, appeal to tradition. In the homebuilder example above, the project manager's cutting quality in years past may not have been detected by homeowners who knew nothing about construction quality. And none of the project manager's workers may have told top management about the project manager's actions. That past, however, does not guarantee the future. New homeowners may be more knowledgeable and future workers may inform management of the project manager's quality-cutting actions.

Another consequence of overoptimism is believing that complex problems have simple solutions. That leads to the next common trait of bad decision making.

Complexity of the Issues

Closely aligned to and aggravated by overconfidence is the failure of decision makers to understand the complexity of an issue. A manager may perceive that the facts are simpler than reality and, therefore, not see that there is little margin for error. Consequently, the executive has not considered the full range of possible solutions and has failed to find the one solution that best matches the facts.

Restated, the decision maker has not done all the investigation and thinking required by the Guidelines for Ethical Decision Making and, therefore, has not discovered all the facts and considered all the reasonable courses of action necessary to making a prudent decision.

The impediments to knowing all the facts, understanding the complexity of a problem, and doing the hard work to create and evaluate all possible solutions to a problem are known to all of us. Fatigue, laziness, overconfidence, and forgetting goals play roles in promoting ignorance of critical facts. We may also want to be team players, by following the lead of a colleague or the order of a boss. These human tendencies deter us from making the effort to find the facts and to consider all options.

Resisting Requests to Act Unethically

Even if we follow the Guidelines for Ethical Decision Making and avoid the pitfalls of fallacious reasoning, not everyone is a CEO or his own boss and able to make decisions that everyone else follows. Sure, if you control a firm, you will do the right thing. But the reality is that for most people in the business world, other people make many decisions that you are asked to carry out. What do you do when asked to do something unethical? How can you resist a boss's request to act unethically? What could employees at WorldCom have done when its CFO instructed them to falsify the firm's books, or employees at Arthur Andersen when a partner ordered them to shred evidence?

Recognizing Unethical Requests and Bosses A person must recognize whether he has been asked to do something unethical. While this sounds simple considering we have spent most of this chapter helping you make just that kind of decision, there are structural problems that interfere with your ability to perform an ethical analysis when a boss or colleague asks you to do something. Many of us are inclined to be team players and "do as we are told" by a superior. Therefore, it is important to recognize any tendency to accept appeals to authority and to resist the temptation to follow orders blindly. We do not want to be like the Enron accounting employee who returned to his alma mater and was asked by a student, "What do you do at Enron?" When considering that question, a question he never posed to himself, he realized that his only job was to remove liabilities from Enron's balance sheet.

For most bosses' orders, such an analysis will be unnecessary. Most of the time, a boss is herself ethical and will not ask us to do something wrong. But there are exceptions that require us to be on the lookout. Moreover, some bosses have questionable integrity, and they are more likely to give us unethical orders. Therefore, it will be helpful if we can identify bosses who have shaky ethics, for whom we should put up our ethical antennae when they come to us with a task.

Business ethicists have attempted to identify executives with questionable integrity by their actions. Ethical bosses have the ability to "tell it like it is" while those with less integrity say one thing and do another. Ethical bosses have the ability to acknowledge that they have failed, whereas those with low integrity often insist on being right all the time. Ethical bosses try to build a consensus before making an important decision; unethical bosses may generate support for their decisions with intimidation through anger and threats. Ethical bosses can think about the needs of others beside themselves. Bosses with low integrity who misuse their workers by asking them to act unethically often mistreat other people also, like secretaries and waiters.

If we pay attention to these details, we will be better able to consider the "source" when we are asked to do something by a boss and, therefore, more sensitive to the need to scrutinize the ethics of a boss's request.

Buying Time If we think a requested action is or might be unethical, what is done next? How can we refuse to do something a boss has ordered us to do? One key is to buy some time before you have to execute the boss's order. Buying time allows you to find more facts, to understand an act's impact on the firm's stakeholders, and to evaluate the ethics of the action. It also lets you find other alternatives that achieve the boss's objectives without compromising your values. Delay also gives you time to speak with the firm's ethics officer and other confidants.

How do you buy time? If the request is in an e-mail, you might delay responding to it. Or you could answer that you have received the e-mail and will give your attention to it when you finish with the task you are working on. Similar tactics can be used with phone calls and other direct orders. Even a few hours can help your decision. Depending on the order and your ability to stack delay on top of delay, you may be able to give yourself days or weeks to find a solution to your dilemma.

The most important reason for buying time is it allows you to seek advice and assistance from other people, especially those in the firm. That brings us to the next tactic for dealing with unethical requests.

Find a Mentor and a Peer Support Group Having a support system is one of the most important keys to survival in any organization, and it is best to put a system in place when you start working at the firm. Your support system can improve and help defend your decisions. It can also give you access to executives who hold the power to overrule your boss. Your support system should include a mentor and a network of other employees with circumstances similar to your own.

A mentor who is well established, well respected, and highly placed in the firm will help you negotiate the pitfalls that destroy employees who are ignorant of a firm's culture. A mentor can be a sounding board for your decisions; he can provide information on those who can be expected to help you and those who could hurt you; he can advise you of the procedures you should follow to avoid antagonizing potential allies. A mentor can also defend

you and provide protection when you oppose a boss's decision. Many firms have a mentorship program, but if not or if your assigned mentor is deficient, you should find an appropriate mentor soon after you join the firm. Be sure to keep him updated regularly on what you are doing. By letting a mentor know that you care to keep him informed, he becomes invested in you and your career.

You should also build a community of your peers by creating a network of other workers who share your values and interests. You may want to find others who joined the firm at about the same time you did, who are about the same age, who share your passion for the firm's products and services, and who have strong ethical values. To cement the relationship, your peer support group should meet regularly, such as twice a week at work during 15-minute coffee breaks. This group can give you advice, help with difficult decisions, and unite to back up your ethical decisions.

Find Win-Win Solutions As we learned from the Guidelines for Ethical Decision Making, many times there are more than the two options of doing and not doing something. There are a number of choices in between those extremes, and the best solution may be one unconnected to them. For example, suppose your boss has ordered you to fire someone who works under you. The worker's productivity may be lagging, and perhaps he has made a few costly mistakes. Yet you think it would be wrong to fire the worker at this time. What do you do?

Find a win-win solution, that is, a compromise that works for you and your boss. First, discover your boss's wants. Probably you will find that your boss wants an employee who makes no or few mistakes and has a certain level of productivity. Next determine what is needed for the affected employee to reach that level. If you find the employee is having emotional problems that interfere with his work, are they temporary or can we help him handle them? Can we make him more productive by giving him more training? Is the employee unmotivated or is he unaware that he lags behind other workers? Should we give him a warning and place him on probationary status for a month, releasing him if there is no satisfactory improvement? These alternatives may address your boss's concerns about the employee without compromising your ethical values.

In other contexts, you may need to approach your boss directly and show that her order is not right for the firm. Using the Guidelines for Ethical Decision Making and valid arguments, you may be able to persuade your boss to accept your perspective and avoid an otherwise unethical decision. Finding a win-win solution is possible only when there is room for compromise. The Ethical Guidelines and logical arguments are effective when your boss respects reason and wants to act ethically. However, when you face an intractable executive demanding you do something illegal, a different response is needed.

Work within the Firm to Stop the Unethical Act Suppose you receive an order from an executive you know or suspect to be corrupt. For example, a CFO is motivated to increase the price of the firm's stock in order to make her stock options more valuable. She orders you to book in the current year revenue that in fact will not be received for at least two years, if ever. Booking that revenue would be fraudulent, unethical, and illegal. You are convinced the CFO knows of the illegality and will find someone else to book the revenue if you refuse. You probably will lose your job if you do not cooperate. What do you do?

This is when your mentor, peer support group, and corporate ethics officer can help you. Your mentor may have access to the CEO or audit committee, who if honest should back you and fire the CFO. Your peer support group might have similar access. The corporate ethics officer, especially if she is a lawyer in the firm's legal department, can also provide her backing and that of the legal department.

There is one large caveat, however. While the situation just described should and probably will result in your support system rallying to your support, in other situations that are ethically ambiguous, you, your mentor, and your support group may find that fighting a battle against a top corporate executive ineffectively expends your and your colleagues' political capital. In other words, you need to pick your battles carefully lest you and your colleagues at the firm be labeled whiners and troublemakers who unnecessarily seek intervention from higher level corporate executives. This is why we have listed this alternative near the end of our discussion. In most situations, it is better to rely on your colleagues as advisors and to execute win-win solutions in cooperation with your boss.

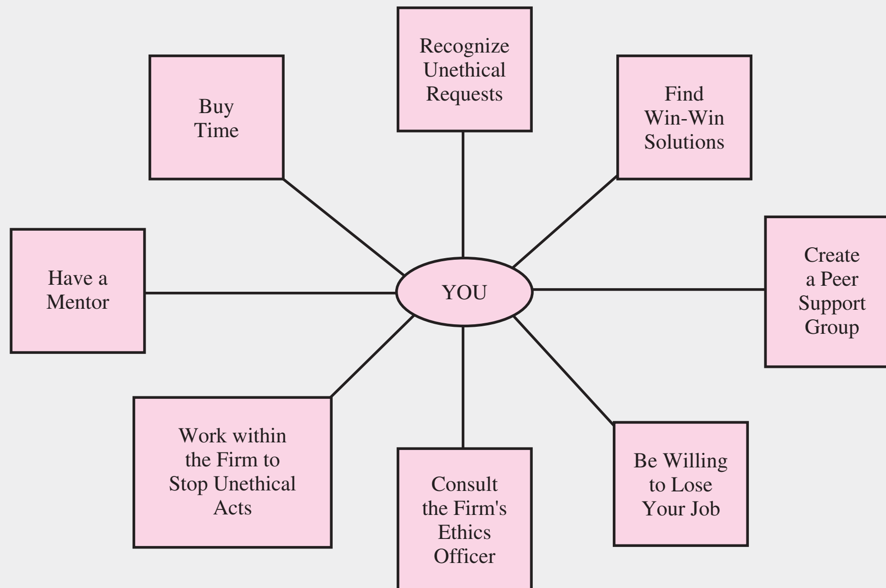
But if neither compromise nor other intrafirm tactics protect you from unethical requests, you are left with a final tactic.

Prepare to Lose Your Job This is the last tactic, because by quitting or losing your job you are deprived of your ability to help the firm make ethical decisions. Only as an employee can you craft win-win solutions or work within the firm to do the right thing.

But if a firm's executives and its internal governance are so corrupted that neither compromise nor reason can

Concept Review

Resisting Requests to Do Unethical Acts



steer the firm away from an unethical and illegal course, you must be willing to walk away from your job or be fired for standing up for your values. Do not want your job and the status it brings so much that you are willing to compromise more important values. It is tough losing a job when one has obligations to family, banks, and other creditors as well as aspirations for a better life. But if you prepare yourself financially from day one, putting away money for an ethical rainy day, you will protect more important values.

Leading Ethically

Some day, perhaps today, you will be in charge of other people in your business organization. You may be managing a four-person team, you may be a vice-president of marketing in charge of a department, or you may eventually be a CEO directing an entire company. You give the people under your charge tasks to complete, supervise their work, help them complete the tasks, and provide motivation and feedback to ensure that the current job will be done well and that future work will be done better. So how do you also ensure that all those people under your charge act ethically? This is the daily challenge of ethical business leaders, who must not only act ethically themselves, but also promote ethical behavior of their workers.

Be Ethical

No one can lead ethically who does not attempt and mostly succeed in behaving ethically in her business and personal life. Few underlings respect an unethical leader, and many will be tempted to rationalize their own unethical conduct when they see their leaders acting unethically. They fall prey to the bandwagon fallacy, arguing for example that since the CFO is doing something wrong, so may they. For the same reason, ethical behavior by good managers encourages ethical behavior by underlings, who often view their bosses as role models and guides for advancing in the corporation. If they see an ethical boss moving up in the business, they will believe that the system is fair and that they, too, by acting ethically, can advance at the firm.

Communicate the Firm's Core Ethical Values

For CEOs, creating, communicating, and emphasizing the firm's core values are essential to creating

an ethical environment that rubs off on all employees. For other managers, recommunicating and reemphasizing the firm's value are also important.

All public companies today have ethics codes, as do many smaller companies. Yet the CEO who leads ethically must continually emphasize in written messages and speeches the importance and necessity that everyone comply with the code. Other top level managers, such as the vice president of finance, should ensure that their staffs understand the ethics code's application to their corporate tasks and make ethical reviews part of the staffs' annual evaluations. A lower level manager who supervises a small staff for a single project should also do her part to encourage compliance with the ethics code by pointing out how the code relates to the project assignment and including ethics in the project team's progress reports.

Connect Ethical Behavior with the Firm's and Workers' Best Interests

It is one thing to educate your staff about ethical behavior and another to obtain compliance. One good way to increase compliance with the firm's core ethical values is to convince the staff that their best interests—and the firm's—are met by acting ethically. Management should help employees understand that the firm's profitability and the employee's advancement in the firm are optimized by each employee taking responsibility for acting ethically. Staff must understand that adverse publicity caused by unethical conduct harms a firm's ability to promote itself and its products and services. The ethical manager also clearly establishes ethical behavior as a prerequisite for salary increases and promotions, or at least that unethical behavior is a disqualifier.

Reinforce Ethical Behavior

When a manager knows a staff member has acted ethically in a situation in which employees in less ethical firms would be tempted to act unethically, the manager should congratulate and find other ways to reinforce the staff member's behavior. For example, if a staff member reports that a supplier has attempted to bribe him in order to do business with the firm, the ethical manager will praise the staff member and may include a letter commending him in his employment file.

In addition, management should set up a mechanism for its employees to report instances of unethical behavior by the staff. While some employees will view whistle blowing as an act of disloyalty, management should recharacterize whistle blowing as necessary to the protection of the firm's decision-making processes and reputation. Undetected ethical decisions often lead to poor decisions and harm corporate profits. While management does not want witch hunts, good managers must garner evidence of alleged unethical behavior so they may investigate and stop conduct that is harmful to the firm.

A necessary corollary is not reinforcing unethical behavior, including behavior that may lead to an unethical act or foster an environment that appears tolerant of ethical missteps. As with childrearing, and so too with managing a staff, it is usually not acceptable to ignore bad behavior. The ethical leader must reprimand staff for unethical actions and must not tolerate statements that suggest the firm should engage in unethical conduct. For example, if during discussions about how to increase revenue for a product line, one staff member suggests obtaining competitors' agreements to fix prices, a manager running the meeting should make clear that the firm will not engage in that or any other conduct that is illegal. To let the price-fixing comment pass without comment may send the message that the manager and the firm condone illegal or unethical acts.

Collectively, these reinforcing mechanisms should create a culture in which ethical practices define the firm and its employees rather than being imposed on them.

Problems and Problem Cases

1. You are one of three owners of a consulting company with annual revenues of $80,000,000. You are the partner in charge of human resources. One of the company's senior staff consultants, Libby Hope, has worked for your firm for seven years. Libby is the head of her household, supporting her three school-age children and disabled husband. For the last three months, Libby's work performance has declined below her usually high level. Her productivity is now in the lower quarter of the firm's staff consultants. Many of the firm's consultants with years' less experience are outperforming her. Libby's salary is near the highest of the firm's consultants. What do the Guidelines for Ethical Decision Making suggest you do first?
2. You are an outside director of Hook, Inc., a manufacturer of surgical instruments. Hook has 19,000 employees worldwide, including 6,000 mostly manufacturing workers in China, 5,000 mostly manufacturing workers in Mexico, and 3,500 manufacturing and 1,500 executive employees in Springfield, Illinois, where it maintains its corporate headquarters. The CEO has proposed to Hook's board of directors that Hook close its manufacturing facility in Springfield and replace it with a larger facility in Honduras. Using the Guidelines for Ethical Decision

Making, what do you want to know before you decide whether you will support the decision of the CEO?

3. You are a director of SeaGold Canning Company. SeaGold's business is canning tuna and salmon for sale to consumers. Its annual revenue is $575,000,000, 75 percent from tuna sales. SeaGold buys tuna from independent fishermen whose fishing methods do not always permit them to determine whether they are catching tuna or dolphins. The result is that many dolphins are killed. The Society to Protect All Sea Mammals (SPASM) has discovered that fishermen selling to SeaGold have been killing dolphins and has asked SeaGold to demand that the fishermen not kill dolphins and to refuse to buy tuna from fishermen who kill dolphins. If SeaGold does not comply with SPASM's request, SPASM will call a press conference to urge consumers to stop buying SeaGold tuna and salmon.

For fishermen to change their fishing methods would result in SeaGold paying an additional $3,000,000 each year for tuna. If SeaGold passes the cost on to consumers, the price of tuna will increase to $2.05 per can from the present $1.95 per can. Since SeaGold tuna now sells for the same price as other tuna brands, SeaGold expects its sales to fall by 10 percent if it increases the price of its tuna. What would a rights theorist do? What would you do as a SeaGold director?

4. One of your employees is a widower with two preteen children. By working full time for your firm, he is able to make just enough to support his family. He has asked that you allow him to have more flexible work hours than the firm's policies allow, including permitting him to do some work at home. The flexible hours would let him help his children get ready for school and greet them at home when the school day ends. He is able to prove that he can complete all the tasks you give him despite having more flexible hours. Using justice theory, how would you justify a decision to exempt him from the firm's office-hours policies? Would a profit maximizer make the same decision?

5. Marigold Dairy Corporation sells milk products, including powdered milk formula for infants. Marigold hopes to increase sales of its powdered milk formula in Liberia and other African nations where mothers are often malnourished due to drought and civil war. Marigold's marketing department has created a marketing plan to convince mothers and expectant mothers not to breastfeed their babies and instead to use Marigold formula. Doctors generally favor breastfeeding as beneficial to mothers (it helps the uterus return to normal size), to babies (it is nutritious and strengthens the bonds between the infant and the mother), and to families (it is inexpensive). Marigold's marketing plan stresses the good nutrition of its formula and the convenience to parents of using it, including not having to breastfeed.

You are the Senior Vice President of Marketing for Marigold. Do you approve this marketing plan? What would a rights theorist do? What would a utilitarian do? What would a profit maximizer do?

6. During World War II, the insecticide DDT was used successfully to halt a typhus epidemic spread by lice and to control mosquitoes and flies. After World War II, it was used extensively to control agricultural and household pests. Today, DDT may not be used legally in the United States and most other countries. Although DDT has a rather low immediate toxicity to humans and other vertebrates, it becomes concentrated in fatty tissues of the body. In addition, it degrades slowly, remaining toxic in the soil for years after its application. But there has never been any credible evidence that this residue has caused any harm. Even so, DDT has been blamed for the near extinction of bald eagles, whose population has increased greatly since DDT was banned.

In 2002, over 4,000 people in the United States were infected by and over 250 people killed after contracting West Nile virus, which is carried to humans by mosquitoes. CDC director Julie Geberding called West Nile virus an "emerging, infectious disease epidemic" that could be spread all the way to the Pacific Coast by birds and mosquitoes. Pesticides such as malathion, resmethrin, and sumithrin can be effective in killing mosquitoes but are significantly limited because they do not stay in the environment after spraying.

As an executive for Eartho Chemical Company, you have been asked by Eartho's CEO to study whether Eartho should resume the manufacture of DDT. What would a utilitarian decide? What would a profit maximizer do?

7. Gexxeg Company manufactures electrical capacitors. During the manufacturing process, toxic wastes are produced. Gexxeg hires Tox-Rid Corporation to dispose of the waste. Tox-Rid charges $2,000 per day, half the charge of any other toxic waste disposal company. A year after Tox-Rid began disposing Gexxeg's toxic wastes, as Vice President of Business Operations, you discover that Tox-Rid is not disposing of the waste properly, but merely dumping it in a field. The waste has contaminated the dirt in the field and groundwater beneath it.

A corporation that knowingly has another person dispose of its toxic waste illegally is subject to a fine of $50,000 per day. However, there is only a 2 percent chance that the dumping will be detected in the next 10 years. Besides, no one else at Gexxeg knows about the illegal dumping and no one knows that you know about the dumping. Hence, it would be difficult, if not impossible, to prove that Gexxeg knowingly had someone dispose of its toxic waste illegally.

What do you do if you believe that ethics requires you to maximize Gexxeg's profits?

8. You are a partner in an investment banking firm. One of your clients is a software company that has seen dramatic increases in its revenues and profits in the last three years. The firm's CEO has dominated the company for its entire five-year life. The CEO and her children own 80 percent of the company's shares, and the corporation's directors comprise only the CEO, her three children, and three of her closest friends.

As the investment banker, you recommend that the corporation go public by selling an additional 30,000,000 shares in an initial public offering (IPO). After the IPO, 40 percent of the company's shares will be held by persons outside the CEO's family. The CEO will control a majority of the shares.

You want to optimize the price of the IPO shares by making the shares more attractive to public investors. What corporate governance improvements do you recommend the client adopt to increase the IPO's price?

9. In 2002, the National Council of Women's Organizations demanded that the all-male Augusta National Golf Club, which hosts the annual Masters Tournament in April, admit women as members. When rebuffed by Augusta National, the NCWO approached IBM and The Coca-Cola Company, sponsors of the Masters Tournament, to attempt to encourage them to withdraw as sponsors of the Masters. NCWO also contacted CBS Television, the national television broadcaster, asking that CBS not broadcast the tournament. On a national sports radio show, the NCWO admitted that Augusta has the legal right to be an all-male club under the laws of Georgia and the United States. When asked to explain why Augusta National should open its membership to women, an NCWO representative stated that discriminating against women is wrong. When asked to explain further, the representative said, "Because it's the right thing to do in our society." The radio host asked the NCWO representative why she thought the club excluded women, and she replied, "This is just men being men."

Can you identify the fallacies used by the NCWO?

10. For the last five years, you have been a corporate accountant for Farrless Company, a public company that has seen explosive growth though acquisitions of smaller competitors in its industry, retail pharmacy. Farrless's CFO tells you that Farrless's per store revenue for the fiscal quarter, as yet not publicly disclosed, has dropped by 15 percent. As a result, Farrless has had insufficient cash flow to pay some suppliers, many of whom are refusing to ship additional inventory to Farrless until it pays its outstanding debt to them. The CFO tells you he believes that the revenue drop, while temporary, will continue for the rest of the fiscal year. Next year, he says, per store revenue will be 20 percent more than last year's historic high. Consequently, to avoid a temporary drop in the market price of Farrless's stock, which will reduce the value of the CFO's stock options and make it more expensive for Farrless to raise capital, the CFO wants you to create false accounting entries that will smooth Farrless's revenues.

Can you identify the common characteristics of poor decision making that the CFO is exhibiting? Draft a plan that will help you resist the CFO's request for you to make false accounting entries. What should you have done during the five years you have been working for Farrless to help you now resist the CFO's request?

11. You have been a marketing manager at Pramat-Glomer Company for 10 years. Last week, you were promoted to the position of Assistant Vice President of Marketing. Overseeing a staff of 50 marketing professionals, you report directly to the Executive Vice President of Marketing. Draft a plan that will help ensure that every member of your staff acts ethically in compliance with Pramat-Glover's code of ethics.

Online Research: Josephson Institute of Ethics

Josephson Institute of Ethics is a leading source of materials for businesses and executives who want to act ethically.

- Find the Josephson Web site.
- List the "Seven Steps to Better Decisions" and the "Six Pillars of Character."
- You can also participate in discussions on ethics at the Josephson chat room.